STATE OF NEW JERSEY

FIRST REPORT

OF

The Commission on State Tax Policy

TRENTON, NEW JERSEY

1946

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FIRST REPORT

OF

The Commission on State Tax Policy

Appointed Pursuant to Laws of 1945, Ch. 157

(Approved April 12, 1945)

Submitted to the Governor and to the Legislature, February 28, 1946

TRENTON, NEW JERSEY

TAXATION

"It had been my hope to be able to recommend the abolition of the State school tax, and to propose ways and means whereby this could be accomplished. The beginning made by the last session of the Legislature in removing $4,000,000 from this tax and thereby saving every property taxpayer eight points in the annual property tax levy was an encouraging and progressive start. I had planned to urge that you complete the program this year. The recent decision of the Court of Errors and Appeals, pertaining to the distribution of delinquent railroad tax interest, deprived us, however, of a large part of the money necessary for the complete removal of the State school tax. I regret, therefore, that I am unable to suggest at this time ways and means of removing this tax without the imposition of new taxes. This is particularly disappointing because of the unique legal grounds upon which the court came to its amazing decision.

"The *Commission on State Tax Policy* will file its first annual report with you within a few days, and will recommend, among other proposals, a way to resolve the conflict between State and Federal law as it pertains to the State bank stock tax. As you will recall, the Legislature of last year passed an act, as a companion measure to the so-called "Corporate Net Worth Tax," exempting all intangible personal property from taxation, with some necessary exceptions. As the law now stands, therefore, the capital stock of both State and national banks remains taxable under the State bank stock tax at 7.5 mills, while all other intangible personalty in the hands of individuals and in competition with national banks, is tax exempt under the new law.

"While this circumstance was well known to the State at the time the 'Net Worth Tax Act' was passed; and was fully explained in the report to the Legislature by the Commission on Taxation of Intangible Personal Property, the present situation violates an old Federal rule; namely, that the shares of capital stock of national banks cannot be taxed at a rate in excess of that imposed on other moneyed capital in the hands of individuals and in competition with national banks. This places our banks in a position whereby they may be unable to pay this year's bank stock tax (amounting to some $942,000 in 1944) without risking personal liability on the part of the directors for an illegal disbursement of bank funds. This condition must be remedied at once; and I commend the proposals of the Commission on State Tax Policy to your consideration.

"There is one other matter that may come before you. There have been numerous requests to alter certain portions of the 'Net Worth Tax Act,' passed by you at the last session of the Legislature. This act has been, on the whole, very well received; but some of the corporations affected by the act—particularly large holding companies, personal holding companies and some investment trusts—feel that certain adjustments are necessary. This may well prove to be the case. It is impossible to foresee all the implications of large-scale tax legislation—particularly where we have had no previous experience with this type of tax. I would, nevertheless, strongly suggest to you, that we wait for one full year's experience under this act before any amendments are attempted."

—GOVERNOR WALTER E. EDGE.

Second Annual Message to the Legislature, January 8, 1946.

STATE OF NEW JERSEY

LAWS (1945) CH. 157

AN ACT creating a Commission on State Tax Policy.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. A Commission on State Tax Policy is created which shall consist of seven members, one of whom shall be a member of the Senate to be appointed by the President of the Senate, one a member of the General Assembly to be appointed by the Speaker thereof, and five citizens of this State to be appointed by the Governor, each of whom shall hold office until the second Tuesday of January following the date of his appointment; except that the first members shall be John F. Sly, of Princeton; David Van Alstyne, Jr., of Englewood; Jacob S. Glickenhaus, of Newark; W. Paul Stillman, of Newark; Norman F. S. Russell, of Burlington, and two other members to be appointed by the Governor, and they shall hold office until the second Tuesday of January, one thousand nine hundred and forty-six.

2. Vacancies caused otherwise than by expiration of terms shall be filled for the unexpired term only. Members shall serve without salary but shall be reimbursed for traveling and other expenses actually and necessarily incurred in the performance of their duties.

3. The commission shall engage in continuous study of the State and local tax structure and related fiscal problems, with particular attention to (a) all laws relating to the assessment and collection of taxes in this State; (b) all proposals for change in such laws; and (c) the impact of Federal tax laws of the State financial structure.

4. The commission shall determine the respects in which the existing tax laws may be simplified, modified, rearranged, consolidated and revised to insure greater efficiency in the assessment and collection of all taxes.

5. The commission shall report annually on the second Tuesday in January to the Governor and the Legislature, setting forth the result of its studies of the preceding year and shall make such recommendations, as it shall deem fit, for changes in our laws relating to the assessment and collection of taxes and for sound and equitable methods of supporting the public services.

6. The commission may hold hearings in any part of the State, and by its subpœna may compel the attendance of witnesses and the production of books, papers and records. It may draft necessary legal and clerical assistance from any State department as may be required. It may engage such competent counsel and expert advisors on the subject of taxation as it may deem necessary to the proper accomplishment of the purposes of this act; *provided,* that the compensation to be paid such counsel or advisors shall at all times be within the limits of the appropriation made therefor.

7. There is appropriated to the commission the sum of ten thousand dollars ($10,000.00) for the fiscal year ending June thirtieth, one thousand nine hundred and forty-six.

8. This act shall take effect immediately.

Approved April 12, 1945.

STATE OF NEW JERSEY

COMMISSION ON STATE TAX POLICY

[*Laws of 1945*, Ch. 157]

JOHN F. SLY, *Chairman*
Professor of Politics, Princeton University
Princeton

W. PAUL STILLMAN, *Vice-Chairman*
President, National State Bank
Newark

AMOS DIXON
Assemblyman, Sussex County
Stillwater

CHARLES ENGLISH
Mayor
Red Bank

JACOB S. GLICKENHAUS
Freeholder, Essex County
Newark

NORMAN F. S. RUSSELL
President, United States Pipe and Foundry Company
Burlington

DAVID VAN ALSTYNE, JR.
Senator, Bergen County
Englewood

STAFF MEMBERS
Research Consultants

JAMES A. ARNOLD, JR.

WILLIAM MILLER

The members of the *Commission* were named in the act creating the *Commission* [*Laws of 1945*, Ch. 157]; except Mr. Dixon and Mr. English who were appointed by the Governor.

As of January 30, 1946, Senator Charles K. Barton, of Passaic County, was appointed by the President of the Senate to succeed David Van Alstyne, Jr., Senator from Bergen County. The other members of the *Commission* were reappointed for the year 1946.

CONTENTS

LETTER OF TRANSMITTAL

COMMISSION ON STATE TAX POLICY

20 NASSAU STREET, PRINCETON, NEW JERSEY

February 28, 1946.

To the Governor and Members of the Legislature:

The *Commission on State Tax Policy* transmits herewith its first report to the Governor and to the Legislature as authorized and directed under *Laws of* 1945, ch. 157.

In last year's report of the *Commission on Taxation of Intangible Personal Property* (of which five of the present Commissioners were members), attention was called to important and necessary adjustments in the tax structure of the State which were in the nature of "unfinished business." These adjustments were listed as follows:

1. The taxation of tangible personal property used in business (inventories, machinery, equipment, raw material, *etc.*) was thought to be as erratic as the tax treatment of intangible personal property. The report stated: "Though neither as extreme nor as drastic as the intangible problem, 'tax lightning' is a real hazard on [tangible] business personalty and has the additional danger of being more widespread, more consistently and more continuously applied and equally subject to abuse and discrimination." [1]

2. The complete exemption of intangible personal property from taxation recommended by the *Report* and subsequently enacted into law by the Legislature (*Laws of* 1945, ch. 163), left unanswered important questions pertaining to the taxation of intangibles in the hands of individuals. The *Report* stated: "At present they offer no problem as compared to corporate-held intangibles, but their exemption from taxation, nevertheless, raises important questions of both policy and methods." [2]

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[1] New Jersey, Commission on Taxation of Intangible Personal Property, *Report* (March 26, 1945), Trenton, New Jersey, 1945, p. 85. Hereafter cited *Report* (March 26, 1945).

[2] *Report* (March 26, 1945), p. 86.

3. Among the questions pertaining to the taxation of intangibles held by individuals was the effect of their exemption from taxation on the constitutionality of the present bank stock tax (*R. S.* 54:9–1 to 54:9–18). The *Report* emphasized that the State could tax national banks only to the extent authorized by Congress in the Federal statutes (*R. S.* 5219; 12 *U. S. C. A.*, sec. 548); and added that "it is quite probable that the complete exemption of all intangible personalty held by individuals in New Jersey will create a substantial basis for litigation in which the bank stock tax could be declared unconstitutional as to national banks";[3] and

4. The *Report* further stated: "The taxation of farm and household personalty is still another field which requires thorough examination and adjustment. This is of great importance to our rural counties and of equal importance to our suburban areas. Particularly in the matter of household personalty, the *Commission* has been impressed with evidence of the greatest discrimination and neglect—not only as among municipalities, but among individual taxpayers themselves."[4]

* * *

The *Commission on State Tax Policy* has given consideration to each of these problems in preparing its recommendations to the Governor and to the Legislature for this year. It considers the question of the taxation of tangible personal property used in business as perhaps the most important tax problem before the State. There can be no question but that the removal of "tax lightning" as it applied to intangible personalty, the adoption by the Legislature of a reasonable corporate net worth tax, and the continued absence of income or sales taxes, have helped to make New Jersey a "favorable tax State" from the standpoint of operating business. This condition should aid the development of maximum prosperity and full employment opportunities—major considerations in establishing a tax structure for any industrial State, and particularly significant in a period of industrial relocation (of both labor and capital) which characterizes the present reconversion period.[5]

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[3] *Ibid.*, p. 86.

[4] *Ibid.*, p. 87.

[5] Recent studies on comparative tax costs have developed another factor which, while still helping to make New Jersey "a favorable tax State from the standpoint of operating business," is not as comforting as those factors mentioned above. The application of New Jersey property tax rates to the full value of all taxable real estate and personal property owned by business firms would in most instances produce an excessive tax. The average property tax rate in the State was $4.74 (1944) for each $100 of valuation taxable. This means a potential tax liability amounting to 4.74 per cent of the value of real and tangible personal property *each year*; and many of New Jersey's most highly industrialized areas have property tax rates in excess of the average State rate.

Property taxes account, moreover, for most of the taxes paid by business in New Jersey. While corporate business now pays a tax upon net worth, this tax is neither

But the present *ad valorem* tax on business tangibles (inventories, machinery, livestock, equipment, raw materials, goods in process, finished products, *etc.*), assessed and collected locally and taxed at the local rate, provides opportunities for "tax lightning" even more serious, perhaps, than the abuses so long associated with the similar taxation of intangibles. As municipal demands for revenue increase (as they must during a period of rising prices, long-deferred capital needs, and the urgency of neglected repairs and improvements), tangible personalty used in business will be particularly vulnerable to new and additional tax demands from local governments. Recent experiences in Newark and elsewhere have emphasized this tendency, which, with the present high tax burden on real estate and the removal of intangibles from the local tax base will doubtless increase; and will tend, moreover, to effect unevenly a comparatively small group of taxpayers whose business personalty is both large and easily accessible.

The correction of this condition will remove the last important tax obstacle to operating business in New Jersey. It will require, however, a very large adjustment in the State tax structure. It will not only involve replacement revenue of some $26 millions, the possible substitute of a new tax affecting some 60,000 partnerships and individual proprietorships, and a distribution program that would protect each municipality from losses due to the repeal or modification of the present tax on business tangibles; but it might also require adjustments in the new Corporation Business Tax Act (*Laws of 1945,* ch. 162) and extend to farm and household personalty as well.

The *Commission on Taxation of Intangible Personal Property* was well aware of these implications, and realized that practically no data was available upon which to base such a program. It accordingly recommended to the Legislature that the general tax act be amended to provide that the table of aggregates (as com-

large nor burdensome. Six New Jersey corporations reporting to the *Commission on Taxation of Intangible Personal Property* showed that their total taxes in New Jersey for 1944 (exclusive of unemployment compensation taxes), amounted to substantially less than their income and excise taxes *alone* would have amounted to had these businesses been located in New York or Massachusetts (*Report,* [March 26, 1945], p. 39). While these comparisons were made before the recent change in corporation taxes (*Laws of* 1945, ch. 162), they would require little modification today.

A recent study of comparative tax costs (New York City, Department of Commerce, *Report on Relative Tax Costs within Seven Selected Cities for Three Groups of Manufacturing Industries* (New York, September, 1944), indicates that Newark ranks second in terms of state and local taxes (1944) among the seven cities considered. It is, however, significant, that both the highest and the lowest tax paid by individual corporations included in the study, were found in Newark. In actual practice, the New Jersey property tax provisions are rarely applied in full measure. For this reason, any tax comparisons between New Jersey locations and locations in other States can be based only upon actual tax practices as they are applied to actual business firms. In instances where this has been done, New Jersey has usually been found to be a "favorable tax State."

piled by the county boards of taxation) should present a breakdown of the value of personal property assessed, showing in separate columns:

a. Value of household goods and chattels assessed;
b. Value of farm stock and machinery assessed;
c. Value of stocks in trade, materials used in manufacture and any other personal property assessed under section 54:4–11.
d. Value of all other tangible personal property used in business assessed.

The Legislature accepted this recommendation and the general tax act was amended accordingly (*Laws of* 1945, ch. 163, sec. 8).[6] The assessment date remains, however, October 1, and the tables of aggregates cannot be made available until sometime following April 10 of the succeeding year. While the *Commission* has given considerable thought to this problem, it has not yet had access to the necessary data upon which to base recommendations—and probably will not have until late in 1946. It has decided, therefore, that if the forthcoming data proves to be both adequate and available, the *Commission's* studies in this field shall be completed in time to make recommendations pertaining to the taxation of tangible business personalty and related subjects to the 1947 Legislature.[7]

* * *

This decision left two other fields of "unfinished business" open to the *Commission—first,* the potential tax treatment of intangible personal property in the hands of individuals; and *second,* the effect of the present exemption from taxation of intangibles in the hands of individuals on the constitutionality of the State bank stock tax. These two problems have accordingly occupied the major time of the *Commission* during the past year, and the following report contains the *Commission's* recommendations pertaining to these matters in so far as they can be treated at this time. Their solution involves three types of intangibles classified according to their ownership or to their use:

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[6] The State Director of the Division of Taxation has already required, for the first time in the history of the State, that the county *Abstract of Ratables* for 1945 list "Value of Personal Property Assessed" (column 5) with a breakdown between *tangible* and *intangible* personal property.

[7] It will be noted that the above data, when collected and available, will show the amount of classified personal property *assessed,* but it will not show the amount *assessable.* It will be necessary to develop this information. Tangible personalty held by corporations could be easily obtained from data collected in the administration of the corporation business tax, but some time and effort will be required to develop the necessary information for other forms of business.

First, the taxation of intangibles held by business partnerships or individual proprietorships;

Second, the taxation of intangibles in the hands of individual investors; and

Third, the taxation of intangibles in the hands of individuals and in competition with national banks.

The *Commission* feels that a decision pertaining to the taxation of intangibles in the hands of partnerships and individual proprietorships must await the settlement of the tangible business personalty problem outlined above. It may prove to be desirable to maintain the present exemption, and to substitute an *in lieu* tax—as was done with corporate held intangibles upon the adoption of the corporate net worth tax. The practical tax aspects of such a proposal, however, remain to be tested in the light of data which (as has been pointed out) is not at present available; as well as upon the development of a distribution formula that would satisfy local fiscal requirements.

In considering the taxation of intangibles in the hands of individual investors, the *Commission* must repeat a principle that it has stated on other occasions: Intangible personal property, whatever its ownership may be, cannot be taxed fairly or effectively on a capital basis—in other words, a classified *ad valorem* property tax on intangibles is neither practical nor desirable in New Jersey. The *Commission on Taxation of Intangible Personal Property* set forth the following reasons (among others) to support this position:[8]

> The administrative difficulties are so formidable as to make its successful administration highly doubtful, especially in a heavily industrialized "bridge" state like New Jersey.
>
> The uniformity requirements of the State Constitution—which apply only to property taxes—would not permit any difference of treatment as between large and small holders of intangible personalty nor as between corporate and unincorporated business, although such distinctions may be useful and desirable.
>
> There is at least considerable doubt as to whether a property tax on intangibles could make a fully effective distinction as between business and residence in New Jersey, particularly as to members of a partnership. But such a distinction may be useful and necessary if the State is not to undertake to revamp its entire tax structure at a single stroke.

[8] *Report* (March 26, 1945), pp. 35-36.

> From the viewpoint of comparative tax burdens, the predominant trend of the States throughout the United States has been to abandon entirely the taxation of intangible personalty as property.
>
> A classified *ad valorem* tax [on intangible personal property] received summary and adverse consideration from the 1942 Legislature.[9]

The *Commission* agrees with these opinions and is not prepared to recommend the general taxation of intangibles in the hands of individuals on a capital basis. Not only does this form of taxation seem unsound (for the reasons stated above), but constitutional restrictions might well prevent the classification for tax purposes of intangibles, on the sole basis of ownership. Strong arguments have been advanced for the permanent exemption of such intangibles; but the *Commission* feels that the matter should be considered as a part of the broader adjustments pertaining to tangible personalty, and until this is possible, it has no recommendations to submit.

It is necessary, however, that a portion of this problem be treated at once; namely, the taxation of intangibles in the hands of individuals and in competition with national banks. This is due to the fact that as part of the program including the Corporation Business Tax Act (*Laws of* 1945, ch. 162), the 1945 Legislature enacted chapter 163 which exempted all intangible personal property from *ad valorem* taxation except bank stock and certain insurance company ratables. This brought the present bank stock tax (*R. S.* 54:9–1 through 54:9–18), 7.5 mills on the true value of the capital stock of State and national banks, into conflict with the Federal rule providing that the shares of stock in national banks cannot be taxed at a rate exceeding that imposed on other moneyed capital in the hands of individuals, where such capital comes into competition with the business of national banks (*R. S.* 5219; 12 *U. S. C. A.*, sec. 548).

This condition was well known at the time of the passage of the Corporation Business Tax Act and related laws, and was fully explained in the report of the *Commission on Taxation of Intangible Personal Property.*[10] As the law now stands, therefore, it is very likely that State and national banks cannot legally pay the present bank stock tax without subjecting their directors to

[9] The Joint Legislative Committee reported adversely on the grounds that the proposed bill would impose "new and additional taxes" and that the "objections" could not be overcome by amendments (*Report* (typed), January 12, 1943). The public hearings held by the *Committee,* December 13, 1942 (108 pages, typed), developed extensive controversy over exemptions and exclusions. This problem, alone, offers what seems to the *Commission* to be an almost insuperable obstacle in taxing intangibles in the hands of individuals on a capital basis.

[10] *Report* (March 26, 1945), pp. 86-87.

personal liability for an illegal disbursement of the bank's funds. The proceeds of the tax, totaling $1,119,410 in 1945, are divided equally between the respective counties and the municipalities in which the banks are located (Table 1, p. 4). The question involves difficult legal and administrative questions to which the *Commission* has given careful consideration. It also involves Federal restrictions with respect to either property or income as the tax base.

The choice between a property and an income tax upon competing moneyed capital, permitted by Federal law, is from New Jersey's standpoint more apparent than real. Whatever the merits of either method may be, the *Commission* is well aware that New Jersey is not at present inclined to consider a tax on or even measured by income. The bank stock tax, moreover, is on the bank shares *as property,* and an income tax on competing moneyed capital would fail to meet the Federal requirement, unless banks were similarly taxed. In spite of the *Commission's* reluctance to tax intangibles as property, New Jersey practice and the Federal rule seem to limit the *Commission* to consideration of the "true value" of competing moneyed capital as a measure of the required tax within this limited field of intangible personalty. The *Commission's* conclusions and recommendations concerning this complex question are contained in the following report.

In considering at this time, therefore, the taxation problems pertaining to intangibles which are at present exempt from taxation, the *Commission* respectfully suggests the following procedures:

1. The taxation of intangibles held by partnershsips or individual proprietorships should become part of the larger problem of the taxation of business personalty, with the hope that either a substitute tax or a modified property tax may be developed which will embrace both tangible and intangible personal property—as the net worth tax did in part for corporate held intangibles.

2. It must be recognized that the taxation of intangibles in the hands of individuals cannot be fairly or effectively accomplished by a property tax. They are, moreover, already taxed in part, as a portion of the net worth base of corporations, and any further tax treatment (if desirable), should await decisions pertaining to the adjustment of tangible personalty, which may also require modifications of the net worth tax.

3. The taxation of intangibles (moneyed capital) in the hands of individuals and in competition with national banks must be faced immediately. This is the core of the conflict between Federal statute and the present State bank stock tax, and forms the basis for the major part of the following report and recommendations.

* * *

The *Commission* has spent much time on other matters that have come before it for attention. Among these have been numerous requests for modifications in the Corporation Business Tax Act (1945). For the most part these requests fall within the following categories:

1) Adjustment of the allocation provision of section 5(b) of the Corporation Business Tax Act, requiring the net worth of domestic corporations to be allocated on a basis which attributes all intangible personalty to New Jersey. This is urged particularly by corporations which deem it necessary to operate in foreign countries through subsidiaries, as well as all domestic corporations holding large blocks of intangibles.

2) Permission for corporations to file consolidated returns in reporting their tax liabilities under the act. This is particularly urged by large domestic corporations which operate through subsidiaries in New Jersey, otherwise have few tangible assets in the State, and have experienced a very substantial increase in their State taxes under the new law.

3) Provision for a special allocation factor for financial corporations, such as personal holding companies and investment companies, which do not fall within the statutory classification of "regulated investment companies."

4) Modification of the gross receipts factor, in allocation of net worth under Section 6, by adjustment of the sales attribution basis for all corporations to give more weight to selling activity and the location of customers.[11]

In the enactment of legislation of such far-reaching effects as the Corporation Business Tax Act, it is impossible to foresee all the implications as they may effect individual businesses. Some inequities were implicit in the process of transition from the old property tax. While every care was taken to determine the impact of the new tax on all types of corporate enterprise, and careful estimates made as to the potential yield, it is not possible to speak with full assurance where there is no experience as a guide. The *Commission* has therefore taken the position *that it will recommend no changes in the Corporation Business Tax Act, until a full year's operation under the act has been completed.* At that time, the *Commission* will give the fullest consideration to all taxpayers

[11] Several of these requests were filed with the *Commission* by the Special Committee to Revise the New Jersey Corporation Franchise Tax Law of 1945, of the New Jersey State Chamber of Commerce, in a formal statement *Suggested Changes to the New Jersey Corporation Franchise Tax Law* (Jan. 17, 1946), 14 pp. mimeo.; and a companion statement *Proposed Amendments New Jersey Corporation Franchise Tax Law* (Feb. 7, 1946), 2 pp. mimeo.

who may have proposals for modification of the act; and will make such recommendations to the 1947 Legislature as may seem to be appropriate.

On February 8, however, the *Commission* held a hearing at the request of the Special Committee to Revise the New Jersey Corporation Franchise Tax Law of 1945, of the New Jersey State Chamber of Commerce, to discuss the question of recommending some of the above proposals to the Legislature during the present session. Those speaking for the Committee felt that the present law contained substantial inequities which required excessive payments on the part of some taxpayers, and worked injustices as between domestic and foreign corporations. They further pointed out that inasmuch as a lien applied to the new taxes as of January 1 of each year, the alleged unequal and excessive treatment would continue at least *two* years, unless corrected during the present session.[12]

While the *Commission* conceded that there might, in some cases, be a foundation to these claims, it lacked, at present, any data upon which to measure the effects of the adjustments proposed. It seemed clear, however, that should the adjustments be allowed, a substantial loss in revenue would accrue to the State, which might have to be corrected by an increase in the rate. The *Commission* was, therefore, unwilling to propose amendments until data arising from a year's experience under the act were available. It did, however, entertain a suggestion from the Committee that the date upon which the lien applies (January 1) be moved forward into the ensuing year (for that year only) so as to give the Legislature an opportunity to make such amendments as it deemed appropriate, and, at the same time, to protect the taxpayer from two years of allegedly excessive taxes by avoiding the application of the lien in 1947 until the Legislature had considered the question. The special committee of the State Chamber will prepare an amendment to this effect, and upon examination the *Commission* will recommend such further action as it deems best at this time.

* * *

Tax lien foreclosure is probably as thoroughly enmeshed in the cobwebs of legal antiquity as any other public matter. For many years, there has been pressure in and out of the Legislature for the enactment of an *in rem* foreclosure procedure. Such a procedure would provide an inexpensive, speedy and safe method of

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[12] See *Wilentz v. Hendrickson*, 135 N. J. Eq. 244, 38 Atl. (2d) 199 (1944); *Jersey City v. State Board of Tax Appeals*, 133 N. J. L. 202, 43 Atl. (2d) 799 (1945).

restoring tax delinquent property to its appropriate use. For all practical purposes such property has been abandoned by its owner and yet, prior to foreclosure, it cannot be transferred to any suitable economic use.

From the standpoint of municipal finance, tax liens which have been bought in by the municipality and remain on its books unforeclosed present the unhappy prospect of an annually resulting liability for State and county taxes, which are apportioned on a base including these so-called ratables. But in many cases present costs of foreclosure are so high as to prevent the liquidation of the liens. In an effort to ameliorate this type of situation, the Fiscal Supervision Act supplement [*Laws*, 1941, ch. 75] requires the use of a double tax list but is applicable only to certain municipalities which are subject to the Fiscal Supervision Act [*Laws*, 1938, ch. 127]. The double tax list entails the identification of property on which taxes levied through the three years immediately preceding have not been paid in whole or in part and the listing of such property on a so-called "inactive" list. For the purpose of apportioning State and county taxes, properties on such inactive lists must be excluded from the base. The device is an awkard one at best and was acceptable solely because of the limited situation to which it applied. It does indicate, however, an important aspect of the problem of tax delinquent property.

If an *in rem* foreclosure law were to be adopted, it should be coupled with legislation for the effective disposition of the tax reverted lands, much of which will be found to be sub-marginal in character. California has gone a long way in this direction with a system of classification of such tax reverted lands according to soil characteristics and general economic potentialities, including possible public uses. Depending upon such classification, the uses and disposition of tax reverted property is controlled for its most suitable economic use. Such control is designed to prevent, so far as possible, the return of such property to delinquent tax status. This is a problem that has long been in need of legislative attention, and the *Commission's* findings and recommendations with respect to it appear in Part II of the report.

* * *

The problem of equalizing assessed valuations in the various taxing districts of the State is one of the oldest that has confronted New Jersey. From time to time various efforts have been made to achieve a measure of equalization, and machinery now exists, so far as the statutes are concerned, that is designed to equalize

assessed valuations within the various counties and even among the counties. The failure of this machinery is common knowledge.

The effect of the inequality of assessment ratios among the various municipalities of the State is particularly serious in New Jersey because of the fact that county and State and joint school district taxes are levied among the municipalities according to assessed valuations. There is obviously a strong temptation to evade a measure of these apportioned taxes by deliberately depressing assessed valuations. Additional stimulus in the same direction is afforded by formulas for the distribution of State financial aid to municipalities upon the basis of assessed valuations, such as the formula for relief grants and the various proposals for State aid in support of a foundation school program.

While the problem of equalization is an extremely difficult one, it is clear that so many significant financial relationships are distorted by inequality of assessed valuations that a solution is basic to an effective approach to many other matters of State tax policy. Anything like a State-wide reassessment is impractical. The purpose might be, however, to develop techniques of equalization which would make it possible to operate the existing machinery to advantage. For example: A promising method of relieving the pressure for artificially created assessment inequalities might be to abandon assessed valuations as the basis of apportioning State and county tax burdens among the taxing districts. This has been accomplished in Connecticut through the use of expenditures for local purposes (in place of assessments) as the apportionment basis. The implications of such a method in this State appear to be worth investigation.

The revitalization of the existing State equalization function is also a promising field of study. This would require the development of techniques, some of which are already available, for use in the preparation of an equalized State table of aggregates. It is possible that a reasonably inexpensive procedure might be worked up for this purpose. If successful, it would mean that local assessment practices would remain undisturbed; but that the apportionment of State and county taxes would be made on the basis of equalized valuations. The same equalized valuations would, of course, be available for use in connection with formulas distributing State aid. This is another large project that would take some time to perfect, but the *Commission* would like to record it as a program that must sometime in the near future receive the attention of the Legislature.

* * *

The *Commission* regrets that it cannot present recommendations on more of these problems to this session of the Legislature. The limitations of time and staff have required that its efforts be concentrated on the pressing matter of the State bank stock tax, and the less difficult problem of tax lien foreclosure. The *Commission's* conclusions and recommendations on these matters are found in the following pages. It seems fitting, however, to conclude this letter with the admonition of the former *Commission on Taxation of Intangible Personal Property:*

> It is impossible to treat any portion of the New Jersey tax structure and not raise large ancillary problems, some of which are more significant than the one under consideration. It has been beyond the facilities of the *Commission* to do more than it has proposed and at the same time inform itself on the great need for a thorough examination and adjustment of our tax structure. It would be futile to adopt these proposals and fail to provide for a continuous study of the vital problems that remain. The *Commission* would repeat that no other great industrial State has done so little in the past fifty years to bring its tax structure into line with its social, economic and political development. It not possible to overcome this long neglect with a single statute or a series of statutes. So deep have been the effects of an archaic tax structure that the disturbance of a single exemption or even the adjustment of an important taxpayer threatens to disrupt significant parts of the economy.

Respectfully submitted,

COMMISSION ON STATE TAX POLICY,
JOHN F. SLY, *Chairman,*
W. PAUL STILLMAN, *Vice-Chairman,*
AMOS F. DIXON,
CHARLES R. ENGLISH,
JACOB S. GLICKENHAUS,
NORMAN F. S. RUSSELL,
DAVID VAN ALSTYNE, JR.

HIGHLIGHTS OF CONCLUSIONS AND RECOMMENDATIONS

The Commission unanimously recommends:

PART I

I. THAT THE FOLLOWING FINANCIAL INSTITUTIONS CONSIDERED AS A GROUP, REPRESENT SUBSTANTIAL MONEYED CAPITAL IN COMPETITION WITH NATIONAL BANKS WITHIN THE INTENT OF R. S. 5219 AND SHOULD BE REMOVED FROM THE PRESENT EXEMPTION IN ORDER TO SATISFY THE REQUIREMENTS OF THE FEDERAL RULE:

A. *Shares of stock in the following types of corporate enterprise:*

1. Sales finance companies
2. Personal loan companies
3. Small loan companies
4. Commercial paper dealers
5. Investment bankers and brokers dealing in Governments and municipals
6. Mortgage loan companies
7. Any others engaged in the use of moneyed capital for profit by means of loans or discounts, by loans on collateral security, or by investment and reinvestment which the administering authority determines are in substantial competition with the business of national banks.

B. *Capital and undivided profits of:*

Any *unincorporated* business engaged in the same kind of activity as any of the foregoing corporate types, or generally, in the use of moneyed capital for profit by means of loans or discounts, by loans on collateral security, or by investment or reinvestment, which the administering authority determines is in substantial competition with national banks.

Provided, that moneyed capital employed in the following businesses shall not be deemed to be included:

1. Stock insurance companies
2. Mutual insurance companies
3. Credit unions
4. Mutual savings banks
5. Building and loan associations, and
6. Pawn brokers.

Nor shall bonds, notes, or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with such business, be deemed to be moneyed capital for the purposes of the proposed tax.

II. That Competing Moneyed Capital Employed in the Classes of Business Outlined above should be Taxed Directly to the Competing Business Unit.

III. That Banks and Trust Companies with Preferred Stock Outstanding be Limited to the Deduction of Such Preferred Stock as is Held by the R. F. C.

IV. That the Tax on Competing Moneyed Capital Take the Form of a Financial Business Excise Tax Measured by Capital and Undistributed Profits Employed Through Unincorporated Business Units and by the Value of Capital Stock Employed by Corporations, with Deductions for the Assessed Value of Real Estate in New Jersey, for the Value of Intangible Personalty Specially Taxed, and for Further Relief from Double Taxation to the Extent (up to 50 Per Cent) that Subsidiaries Are Already Taxed in This State.

V. That Capital Employed be Allocated in Proportion to Gross Business Done in New Jersey, as Herein Defined.

VI. Retention of the Bank Stock Tax Rate of 7.5 Mills Upon Taxable Capital, Surplus and Undivided Profits, and the Extension of the Same Rate to Competing Businesses.

VII. That no Specific Yield of the Proposed Tax be Anticipated for the Current Year in County and Municipal Budgets, Although Substantial Revenue, Comparable to the Bank Stock Tax, may be Realized.

VIII. That the Proposed Tax be Assessed and Collected in the Same Manner as the Present Corporation Business Tax, and that the Proceeds be Distributed in the Same Manner as the Bank Stock Tax.

Part II

IX. That An In Rem Tax Lien Foreclosure Law be Enacted for the Use of Taxing Districts in the Liquidation of Liens on Unimproved Property which is Tax Delinquent for at least Four Years after a Tax Sale.

X. That Municipalities be Given Specific Authority to Furnish Warranty Deeds—as is Now the Practice of a Number of Local Governments.

First Report of the Commission on State Tax Policy

PART I

Taxation of Intangibles in the Hands of Individuals and in Competition with National Banks

There is no better statement of the circumstances that give rise to this problem than a letter published in the *Bulletin* of the New Jersey Bankers Association on November 19 of this year. It reads as follows:[1]

> *To the Members of the New Jersey Bankers Association:*
>
> "Your attention is respectfully directed to a legal opinion, prepared by counsel to the New Jersey Bankers Association, pertaining to bank stock taxation in New Jersey. The opinion is printed in full following this letter.
>
> "It appears that, in the opinion of counsel, the national banks, and probably the State banks also, will not be permitted by law to pay the bank stock tax for 1946 unless the State Legislature takes appropriate action at its forthcoming session which convenes on January 8.
>
> "Simply stated, the circumstances which caused this situation are as follows:
>
> "A companion measure to the *Corporation Business Tax Act* (1945) (popularly known as "The Net Worth Tax") passed by the last session of the Legislature, exempted from taxation all intangible personal property in the State of New Jersey other than bank stock and certain insurance company ratables. As the law now stands, therefore, the capital stock of both national and state banks continues to be taxed at the rate of 7½ mills upon true value, while all other intangible personalty in the hands of individuals is entirely exempt from taxation. The effect of the 1945 legislation placed the bank stock tax in conflict with the old Federal rule limiting the authority of the states to tax shares of national banks; namely, that the capital stock of national banks cannot be taxed at a rate exceeding that imposed on other moneyed capital in the hands of individuals where such capital comes into competition with the business of national banks.

[1] New Jersey Bankers Association, *Bulletin* (November 19, 1945), pp. 1-2.

"These circumstances were well known to the State when the corporation business tax act and the intangibles tax repealer were passed. The State Commission on Taxation of Intangible Personal Property explained the circumstances fully in its report to the Legislature in March of last year. The Commission pointed out that this matter involved important questions of policy and methods requiring separate study, and therefore deferred a recommendation with respect to its solution. The 1945 Legislature accordingly enacted the repealer of the intangible tax without disturbing the bank stock tax.

"I know that I speak for all the bankers of New Jersey when I say that they desire to do everything possible to assure that the tax on their shares of stock remains legally sound and is paid promptly when due. We are particularly anxious to recognize our obligation in this respect since this tax is applied toward support of county and municipal governments to the extent of some $900,000 each year. The enclosed statement accordingly advises you of legal adjustments which are necessary to consider as part of the problem in resolving a temporary conflict between State and Federal law.

"We are advised by the Commission on State Tax Policy that it has given extensive consideration to this problem. The Commission further advises that it is now preparing appropriate legislation to bring our present bank stock law into conformity with requirements of the Federal statute.

"While we have every reason to believe that the statutory conflict with Federal law will be corrected early in the coming session of the Legislature, the enclosed opinion of counsel suggests such steps as it is desirable to take pending the enactment of remedial legislation.

Respectfully submitted,

HARRISON THOMAS, *President,*
New Jersey Bankers Association."

* * *

The passage of the Corporation Business Tax Act and ancillary legislation by the 1945 Legislature, created the following conditions pertaining to two types of intangible personal property:

First, Intangible personal property formerly assessed under the general property tax act—*this property was declared to be entirely exempt from taxation.*[2]

Second, Intangible personal property specially assessed under the State bank stock tax—*this property remained taxable as heretofore.*

[2] Except for the taxation of capital and surplus of insurance companies.

The State bank stock tax is a tax upon the shares (common stock only) of both State and national banks, and is assessable against the respective stockholders by the county boards of taxation and payable upon demand by the county treasurer (*R. S.* 54:9–12). The law provides, however, that the banks may assume and pay the tax (*R. S.* 54:9–14), which, the *Commission* is informed, is the common practice throughout the State. The rate of the tax is 7.5 mills on the true value of the shares (in effect, the book value minus the preferred stock and the assessed valuation of real estate), and is in lieu of any other tax upon the personal property of the banks. The aggregate yield, $1,119,410 throughout the State in 1945, is divided equally between the county and the municipalities in which the banks are located (Tables 1 and 2, pp. 4, 5). The aggregate yield over the past ten years has been as follows:

AGGREGATE YIELD OF THE BANK STOCK TAX

(1935-1945)*

(Thousands of Dollars)

1935	*1936*	*1937*	*1938*	*1939*	*1940*	*1941*	*1942*	*1943*	*1944*	*1945*
675	616	631	622	615	671	705	780	835	943	1,119

* The steady increase has been due to increased earnings of the banks, retirements of preferred stock and substantial reductions in real estate holdings. In the "boom" years (1929-1931) the yield was over two million dollars each year. The implications of the "bank holiday" caused the extreme recession in the middle thirties.

TABLE 1

THE DISTRIBUTION OF THE PRESENT BANK STOCK TAX
SELECTED YEARS, 1935-1945

Total Tax, by Counties

Counties	*1935*	*1940*	*1944*	*1945*
TOTAL—ALL COUNTIES ...	$675,294	$670,854	$942,638	$1,119,410
Atlantic	15,004	15,048	18,238	21,440
Bergen	62,902	57,158	83,863	98,094
Burlington	23,792	17,356	19,984	23,756
Camden	17,760	20,908	24,682	34,640
Cape May	7,546	7,344	8,422	8,388
Cumberland	13,728	12,394	15,688	22,588
Essex	182,070	180,000	268,726	333,276
Gloucester	21,352	16,094	18,114	21,784
Hudson	79,686	56,076	78,628	90,272
Hunterdon	8,740	13,830	15,198	17,852
Mercer	21,482	29,950	34,964	38,584
Middlesex	20,718	25,744	39,744	46,170
Monmouth	23,436	32,318	37,716	43,852
Morris	29,184	23,760	36,320	38,348
Ocean	12,968	14,106	18,378	17,866
Passaic	46,892	71,310	116,180	134,974
Salem	10,988	10,394	11,840	13,658
Somerset	12,170	14,400	18,742	20,536
Sussex	10,256	10,790	11,480	11,560
Union	40,170	25,324	44,924	59,566
Warren	14,452	16,548	20,806	22,206

SOURCE: County abstracts of ratables for years shown.

Note: 30 per cent of the total bank stock tax in 1945 was paid to Essex County and its municipalities. Three other counties (Passaic, Bergen and Hudson) and their municipalities accounted for another 29 per cent of the total tax. Thus, nearly 60 per cent of the total revenue currently received from the bank stock tax is paid within four of the State's twenty-one counties. This degree of concentration has increased slightly since 1935 when the four counties received 55 per cent of the total.

From the standpoint of revenue, the bank stock tax is significant in only a few counties and municipalities. While all counties receive some revenues from this source, there are many municipalities which have no banks and receive no tax. The total amount received in 1945 by the county and municipalities together amounted to less than $20,000 in five of the State's twenty-one counties (Cape May, Hunterdon, Ocean, Salem and Sussex). It amounted to more than $100,000 in only two counties (Essex and Passaic).

TABLE 2

DISTRIBUTION OF PRESENT BANK STOCK TAX TO MUNICIPALITIES RECEIVING $5,000 OR MORE IN 1945

(1935 and 1945)

Municipality	1935 Amount	1935 Per Cent of Total	1945 Amount	1945 Per Cent of Total
Total—All Municipalities (½ of total tax)	$337,647	100	$559,705	100
Total—Fourteen Municipalities	162,781	48.2	303,195	54.2
Atlantic City	2,208	.7	5,656	1.0
Hackensack	10,453	3.1	10,176	1.8
Rutherford	3,496	1.0	7,279	1.3
Camden	4,918	1.5	10,827	1.9
Newark	69,708	20.6	136,487	24.4
Woodbury	5,783	1.7	5,570	1.0
Jersey City	24,327	7.2	31,282	5.6
Trenton	6,294	1.9	11,405	2.0
New Brunswick	1,125	.3	5,930	1.1
Morristown	7,232	2.1	10,430	1.9
Paterson	15,325	4.5	38,504	6.9
Passaic	5,642	1.7	18,845	3.4
Elizabeth	4,628	1.4	5,421	1.0
Plainfield	1,642	.5	5,383	1.0

SOURCE: County abstracts of ratables for years shown.

Note: Concentration of banking facilities and taxes paid upon them is further illustrated by reference to the amount of bank stock tax received by municipalities. There were only 14 municipalities in the State receiving more than $5,000 from this tax in 1945. These 14 municipalities accounted for 54 per cent of the total received by all municipalities in that year as compared with 48 per cent in 1935. Newark alone received 24 per cent of the total municipal share of the tax paid in 1945.

These two conditions, namely, the broad *exemption* from taxation of all intangibles in the hands of individuals, on the one hand, and the *continued taxation* of intangibles in the form of bank shares, on the other—raised the following question under Federal law, which is the core of the present problem:

> Does the State bank stock tax as applied to national banks, now violate the Federal law (*R. S.* 5219; 12 *U. S. C. A.* 548) which limits State taxation of national banks, and which provides as follows:
>
> "In the case of a tax on said shares [the shares of a national bank] the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks; *Provided,* That bonds, notes, or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the

banking or investment business and representing merely personal investments not made in competition with such business, shall not be deemed moneyed capital within the meaning of this section." [3]

Before determining recommendations for legislative consideration, it was necessary for the *Commission* to obtain as clear an understanding as possible of the phrase "other moneyed capital in the hands of individual citizens . . . coming into competition with the business of national banks." This was required before a definition of the tax base which is mandatory under the Federal act could be adopted.

R. S. 5219 is an old law. The phrases under discussion became part of the Act of 1863 creating the national banking system. The original act made no provision for the taxation of national banks by States or their local subdivisions; but the year following the passage of the act (1864), Congress added such authority, but limited its exercise to the bank's real estate or to the bank's shares. It was at this time that the proviso was added to the effect that the tax on bank shares should "not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens . . . coming into competition with the business of national banks."

The purpose of the proviso was plainly to give a certain amount of protection to national banks from what might have become discriminatory tax legislation on the part of the States. It was obviously designed to maintain bank shares on a tax parity with other securities that come into competition with the banking business. The national banks have always supported the policy, and at one time seem to have regarded it as a valuable prerogative of their national charters. Particularly with the advent of the Federal reserve system, the national bank became an essential agency of the national government, and the protection accorded by *R. S.* 5219 was given an increased emphasis. Whatever may have been the original urgency of such a proviso, it is difficult to believe that any State Legislature today would consider discrimina-

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[3] The proviso quoted in the above citation was added in 1923, with the apparent intention of eliminating individuals from consideration as potential competitors of national banks. The Supreme Court has held, however, that the provision merely reduced to legislative form the judicial rule that the individual competition must come from persons engaged in the business of employing moneyed capital rather than in the investment of surplus resources [*First National Bank v. Anderson*, 269 U. S. 341, 350 (1925)]. The proviso does have some bearing, however, on the kind of business which is within the purview of the principal provision of Section 5219. By using the phrase "not employed or engaged in the banking or *investment* business," the proviso obviously requires a construction that moneyed capital which is engaged in *"investment business"* is in competition with national banks.

tory or oppressive tax legislation against the national banking interests of its State. The rule, nevertheless, remains.

Throughout these years, the phrase "other moneyed capital in the hands of individual citizens . . . coming into competition with the business of national banks" has been construed by numerous court decisions. At one time when several bills were pending before Congress (1922) proposing amendments to the National Banking Act, *The Bulletin of the National Tax Association* contained a brief summary of the law as the author of the article saw it at that time:[4]

> "In various cases the Supreme Court has held that national banks could not lawfully complain of lower taxation on property interests in railroads, business or manufacturing corporations, mining investments, insurance companies, building and loan associations, municipal bonds, shares of foreign corporations of whatever kind, mortgages, judgments and recognizances, or even savings banks making loans on personal securities. The court has been astute in differentiating between a hostile and unfriendly discrimination in favor of other moneyed capital, and a discrimination not unfriendly, but based upon a wise public policy, . . . 'It could not have been the intention of Congress,' said the Supreme Court in *Hepburn* vs. *School Directors,* 23 Wallace 480, 485, 'to exempt bank shares from taxation because *some* moneyed capital was exempt,' plainly intimating that only when all moneyed capital *as such* is given preferential treatment, would the court interfere.
>
> "These rulings and the repeated statement that the 'moneyed capital' must be of the kind which is employed in a business competing with the business of national banks created the widely held belief—among bank people no less than among tax authorities and State officials—that so long as a State put national banks on a parity with State corporations doing a banking business, no ground for complaint existed."

The leading case is an old one—*Mercantile National Bank* vs. *New York,* 121 U. S. 138; 7 Sup. Ct. 826 (1887)—but all subsequent decisions have followed it in principle. Fundamentally, these cases have taken the view that the purpose of *R. S.* 5219, limiting Congressional consent to the taxation of national bank shares, was to keep such shares equally attractive for investment from a tax standpoint, with any other comparable security. The requirement of competition with the business of national banks is accordingly

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[4] Oscar Loser, "State Taxation of National Banks and the Decision in the Richmond Case" in National Tax Association, *Bulletin,* vol. VII, No. 4 (January, 1922), pp. 108-109; see also Walter W. Law, "Hearings on the McFadden Bill, Relative to a Tax on National Banks," *ibid.; Bulletin,* vol. VII, No. 6 (March, 1922), pp. 180-182.

used as a standard with which to compare alternative equity investments for the purchaser of corporate stocks. With this purpose in mind, it seems that "other moneyed capital" includes any enterprise in which the capital employed is money; where the object of the business is the making of profit by the use of money—such as the investment and reinvestment in securities by way of loan, discount or otherwise; loans on collateral security; and the negotiation of loans, either as an instrument of a permanent character or temporarily with a view to sale or repayment and reinvestment.[5]

The business of national banks against which it is necessary to measure alleged competition, is defined in the National Bank Act (*R. S.* 5136; 12 *U. S. C. A.* 24) and the Federal Reserve Act (12 *U. S. C. A.* 248 (k) and 371). They may be summarized as follows:

1) Discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt;

2) Receiving deposits;

3) Buying and selling exchange, coin and bullion;

4) Loaning money on personal security;

5) Acting as a trustee, etc., or in any other fiduciary capacity in which State banks may act, when authorized by the Federal Reserve Board.

6) Dealing in securities and stock by purchasing and selling such securities without recourse, and solely upon the order, and for the account of customers; and

7) Purchasing for its own account investment securities such as marketable obligations, evidencing the indebtedness of any person, co-partnership, association, or corporation in the form of bonds, notes, and/or debentures.[6]

8) Making of first mortgage loans on improved real estate.

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[5] See also *First National Bank v. Hartford*, 273 U. S. 548 (1927) [competing intangibles exempt as property although subject to income tax]; *Minnesota v. First National Bank*, 273 U. S. 561 (1927) [discrimination determined between taxation of bank shares and money and credits in the hands of individuals]; *Merchants National Bank of Richmond v. City of Richmond*, 265 U. S. 635, 41 Sup. Ct. 619 (1929) [intangibles in hands of individuals found to come into competition with national banks in the loan market]; *Iowa-DesMoines National Bank v. Bennett*, 284 U. S. 239, 52 Sup. Ct. 511 (1933) [administrative discrimination invalidated]; *First National Bank of Shreveport et al. v. Louisiana Tax Commission et al.*, 289 U. S. 60, 53 Sup. Ct. 511 (1933). The Shreveport case last cited held that the evidence supported the conclusion of the state court that there was no competition, under the facts shown, between the national banks and concerns engaged in the business of lending money on real estate and mortgages, nor with loan companies or finance companies. This decision seems to mean no more, however, than that it may be possible in given circumstances to show lack of the necessary competition.

[6] The citation from the National Bank Act (*R. S.* 5136; 12 *U. S. C. A.* 24) reads: ". . . To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits, by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing,

In addition to these positive grants of authority there are two important restrictions: a national bank is prohibited from purchasing, for its own account, the shares of stock of any corporation[7] and its power to hold and to convey real estate is specifically restricted as follows (*R. S.* 5137; 12 *U. S. C. A.* 29):

> "But no such association shall hold the possession of any real estate under mortgage, or the title and possession of any real estate purchased to secure any debts due to it, for a longer period than five years."

These appear to be the only restrictions, although both of these types of property (real estate and shares of corporate stock) are acceptable as collateral security. There are, in addition, a number of restrictions on the amount or maturity of other types of investments, such as real estate mortgages, but in general, the potential field of competition covers the activities of almost every type of financial institution.

But for *R. S.* 5219 to apply, the national bank must not only be authorized to engage in a given competitive activity; it must also *exercise the power* and there must, *in fact,* be substantial competition. But the fact of competition is measured not by the importance of the activity to the banks but by the comparative amount of competing moneyed capital more favorably treated. In the case of *Merchants National of Richmond, Va.* vs. *City of Richmond* [265 U. S. 635; 41 Sup. Ct. 619 (1929)], the record showed that in the city of Richmond in 1915, the year of the taxes involved, the aggregate of State and national bank stocks taxed at the higher rate was about $14,000,000 while in the same year there were about $6,250,000 of bonds, notes and other evidences of indebtedness taxed at a lower rate. The court inferred that a substantial part of the intangibles were in the hands of individual taxpayers, and the evidence presented was said to show, without dispute, that the moneyed capital in the hands of individual citizens invested in

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and circulating notes according to the provisions of this chapter. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided,* That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes, and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any corporation."

[7] *Supra,* note 6.

bonds, notes and other evidence of indebtedness came into competition with the national banks in the loan market.

It is important to emphasize that the business of banking has both grown and developed extensively during the past few years. At the same time, the extent of the competitive field has likewise changed. There appear to be no important cases later than 1933. The Supreme Court has always decided each case upon the evidence, depending upon whether or not substantial competition could be shown to exist *in fact*. This means, of course, that cases decided ten or fifteen years ago, when it was far less common for national banks to operate personal loan departments, to engage in sales financing, or to take residential mortgage loans, are now of limited significance.

It must also be borne in mind that prior to the New Jersey legislation of 1945 exempting intangibles from *ad valorem* taxation, the same competition existed between untaxed financial business and national banks as exists today. While the old intangibles law was in accord with the Federal rule, the practice was entirely opposed—that is, "other moneyed capital in the hands of individual citizens . . . coming into competition with the business of national banks" was not, *in fact,* assessed or taxed. No legal test of this condition was ever instituted. But the extreme position in which the banks are now placed under the new legislation, namely, both the *law* and the *fact* being entirely opposed to the Federal rule, seems to make remedial legislation imperative.

The law, indeed, seems clear on this point. The complete exemption accomplished by the New Jersey legislation appears to come squarely within the holding of *First National Bank* vs. *Hartford* [273 U. S. 548 (1927)]. It there appeared that Wisconsin exempted intangibles as property, but taxed the income therefrom under a general income tax. Bank stocks were taxed as personal property to the owners. The evidence showed that various individuals, partnerships and corporations were engaged in the vicinity of plaintiff's banking house and elsewhere in the business of making loans, buying and selling notes, bonds, mortgages and other securities. The court held that *R. S.* 5219 was violated by the attempt to tax bank stocks as personal property without taxing such competing moneyed capital likewise. So far as the controlling Federal cases go, it appears most likely, therefore, that either an individual shareholder or a national bank could successfully attack the validity of the present New Jersey bank stock tax.

* * *

Having found that the conflict with Federal law is so clear-cut as to be inescapable, the *Commission* was faced with the alternatives of either recommending the abandonment of the bank stock tax (entailing a loss of $1,000,000 a year in local revenues) or of proposing some compensatory tax to meet the Federal requirements. This choice was more apparent than real, since the *Commission* is committed to a definite policy of protecting county and municipal budgets from any added reliance upon the general property tax. In considering a compensatory tax, the *Commission* has met with several difficult problems as to the nature and scope of the required remedy. These appear under the following heads:

BASE OF COMPETING MONEYED CAPITAL:

1) *Scope of competition*—What types of business may fairly be said, under present conditions, to constitute the employment of competing moneyed capital?

2) *Other business*—Should any additional businesses which employ moneyed capital, perhaps not technically in competition with national banks, be brought under the proposed tax?

INCIDENCE AND MEASURE:

1) *The incidence of the tax*—Should the tax be assessed against the individual shareholder, or should it be assessed against the competing corporation directly?

2) *The measure of the tax*—Should the measure of the tax on competing business be related to the holding of shares by resident individuals, or, in line with the bank stock tax, to the value of capital stock?

3) *Apportionment of the base*—If the tax is to be assessed against the competing corporation directly, what measure should be used to determine the tax liability of a corporation whose shareholders are non-residents or whose share capital is employed both within and without the State?

RATE AND YIELD:

1) *The rate of the tax*—Should the 7.5 mill rate of the State bank stock tax be continued and extended to competing business, or should some other uniform rate be established?

2) *The yield of the tax*—Should the yield be sustained at substantially the present figure ($1,119,000) or should new money be raised from the extended base?

ADMINISTRATION AND DISTRIBUTION:

1) *Assessment and collection of the tax*—Should the tax be assessed by the county boards of taxation and collected by the county treasurer (as at present under the State bank stock tax), or should the tax be State-assessed and State-collected?

2) *Distribution of the tax*—Should the tax be allocated as at present (one-half to the county and one-half to the municipality in which the financial institution is located), or should a new method of allocation be developed?

* * *

Base of "Competing Moneyed Capital"

There is no question but that the field of competition as between national bank shares and other moneyed capital has been constantly widening. Table 3 shows the increased extent to which banks have entered the field of consumer credit. In a study (1940) Sponsored by the National Bureau of Economic Research, some of the more recent developments have been summarized as follows.[8]

> "One of the most noteworthy developments in contemporary commercial banking has been the rapid expansion of consumer instalment credit activity. Although banks have long participated indirectly in consumer lending by making commercial loans to agencies which specialize in instalment financing, their current interest is in the establishment of their own personal loan and time-sales departments. Through these departments large numbers of commercial banks now extend cash instalment loans directly to consumers, finance instalment purchases on a direct-to-consumer basis and purchase retail instalment paper from dealers. This movement toward direct consumer financing appears to be attributable largely to the need for an outlet for bank funds which may yield higher returns than are available in other fields.
>
> "It is estimated that by the end of 1938, 1,500 commercial banks had functioning personal loan departments. Since many banks have been operating branches through which consumer instalment loans are made, the total number of banking offices now engaged in personal lending probably approaches 3,000. It is estimated further that commercial banks had consumer instalment loan outstandings of $500,000,000, inclusive of sales finance paper, at the close of 1938, and that during the year their services were used by 1,000,000 to 1,500,000 people.

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[8] J. A. Chapman and Associates, *Commercial Banks and Consumer Instalment Credit* (New York, National Bureau of Economic Research, 1940), pp. 3-4, 19.

"Commercial banks reached the position just described after a relatively short period of intensive growth in consumer credit operations. Out of approximately 1,200 known personal loan departments, 80 per cent were established after 1931. In addition, reports from 100 banks show a combined increase of almost 200 per cent in year-end consumer loan outstandings over the five year period 1934-1938.

"Despite this rapid rise in outstandings, consumer loans constitute only a small proportion of the total earning assets of commercial banks. That proportion, however, is tending to increase. Thus for the group of 100 reporting banks, consumer loans rose from .8 per cent of total loans and investments in 1934 to 1.9 per cent in 1938. These figures, moreover, are an inadequate expression of the importance of instalment loans, since the gross return on such transactions is higher than that yielded by most other earning assets.

. . .

"Commercial banks meet their keenest competition in the field of sales financing. Some banks have adopted the policy of soliciting business directly from consumers, usually urging their patronage on grounds of economy. In this competitive situation, however, the crucial element is the retail dealer.

"With regard to organization there are considerable differences between commercial banks and sales finance companies: the former are generally non-branch units, whereas the bulk of sales finance company business is done by national companies. Banks have developed a number of techniques designed to overcome this competitive disadvantage. Available data, while not conclusive, indicate that the customer charges established by commercial banks are either equal to or slightly lower than those maintained by the larger sales finance companies.

TABLE 3

PERCENTAGE DISTRIBUTION OF TOTAL ESTIMATED CONSUMER INSTALMENT OUTSTANDINGS, YEAR-END 1929, 1933, 1936, 1941, BY AGENCY[a]
(Dollar Figures in Millions)

Agency	*1929*	*1933*	*1936*	*1941*
Retail instalment credit				
Sales finance companies	[b]	[b]	[b]	31.1%
Commercial banks	[b]	[b]	[b]	10.7
Insured industrial banks	[b]	[b]	[b]	.7
Other industrial banking companies.	[b]	[b]	[b]	}
Retailers and others	[b]	[b]	[b]	}20.0[c]
Total	78.3%	69.3%	69.4%	62.5%
FHA Title I loans[d]				
Sales finance companies	..	..	1.5	1.0
Commercial banks	..	..	4.7	3.5
Insured industrial banks	..	..	}	.3
Other industrial banking companies.	..	..	} .4	}
Credit unions and others	..	..	.1	} .1
Total	..	..	6.7	4.9
Cash instalment loans[e]				
Personal finance companies	9.6	16.6	9.9	10.2
Commercial banks	1.3	1.8	3.7	12.3
Credit unions	1.0	1.7	1.9	3.4
Insured industrial banks	}			1.6
Other industrial banking companies.	}6.8	7.5	5.4	3.4
Other lenders	3.0	3.1	3.0	1.7
Total	21.7	30.7	23.9	32.6
TOTAL OUTSTANDINGS	100.0%	100.0%	100.0%	100.0%
	$3,211.3	$1,618.9	$3,514.2	$5,997.7

[a] Based on data in the *Survey of Current Business* (November, 1942) pp. 9-25, which revised and brought up to date the National Bureau of Economic Research estimates published in *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan McC. Holthausen in collaboration with Malcolm L. Merriam and Rolf Nugent (New York 1940). For 1941, based, in addition, on data from Federal Deposit Insurance Corporation and Federal Housing Administration.

[b] Breakdown not available.

[c] Holdings of other industrial banking companies are a negligible per cent.

[d] Notes under $2,000 insured by the Federal Housing Administration. Breakdowns estimated from data obtained from the FHA for May 1 call dates.

[e] Includes direct instalment loans for financing retail purchases, repair and modernization loans not insured by the FHA and loans made by unregulated lenders.

[f] Inflated by "interest due and to become due" by the formula $oi\frac{(d+2)}{3}$ with o representing outstandings, i the monthly interest rate and d the duration of the loan. The duration was estimated at 15 months and the monthly interest rate in 1929 at 3.0 per cent, in 1933 at 2.9 per cent, in 1936 at 2.8 per cent, and in 1941 at 2.5 per cent.

SOURCE: Comparative Operating Experience of Consumer Instalment Financing Agencies and Commercial Banks, 1929-41, by Ernst A. Dauer. Financial Research Program, Studies in Consumer Instalment Financing, of the National Bureau of Economic Research. (New York, 1944). p. 33.

As has been pointed out, the purpose of this examination of the cases and the practice, was to place the *Commission* in a position to define "other moneyed capital in the hands of individual citizens . . . coming into competition with the business of national banks" *in terms of a definite tax base.* This means that it is necessary to reduce this information to actual businesses or groups of businesses that can be named in an act, and likewise to exclude certain businesses or groups of businesses that do not fall within the requirements of the Federal rule. In order to obtain the best guidance under New Jersey law, the *Commission* asked the Attorney-General for an opinion. The question of the *Commission* and the answer of the Attorney-General pertaining to this part of the problem are as follows:

> QUESTION: What specific types of business would be held to come within the meaning of the phrase "coming into competition with the business of national banks?"
>
> ANSWER:[9] . . . as I understand the position of the Court from the pertinent cases, the phrase "other moneyed capital" in *R. S.* 5219 (b) embraces moneyed capital employed in such a way as to bring it into substantial competition with the business of national banks, and that the determination of this question in every case is one of fact. Within such competition I find the following referred to in 59 *A. L. R.* 1 at 25: The business of commercial banking, investments in the shares of state banks, trust companies, and in private banks, and any investment business substantially identical with the business carried on by national banks. *First National Bank* vs. *Hartford,* 273 *U. S.* 548 (1927). *Public National Bank* vs. *Keating,* 47 Fed. (2 d) 561.
>
> In *First National Bank* vs. *Hartford, supra,* and in *First National Bank* vs. *Anderson,* 269 *U. S.* 341, and *Merchant National Bank* vs. *Richmond,* 256 *U. S.* 365, the substantial holdings are that moneyed capital employed in the loan and investment business, in the making of investments by way of loans, discounts, and otherwise in notes, bonds, or other securities with a view to sale or repayment and reinvestment is in substantial competition with the business of national banks.
>
> In *State of Minnesota* vs. *First National Bank,* 273 *U. S.* 561 (1927), the opinion shows that under the Minnesota statutes shares of national banks and the moneyed capital of banks or mortgage loan companies were assessed and taxed at 40 per cent of their full value in the district where located. Money and credits were taxed at the rate of three mills on the dollar of their full cash value and were exempt from all other taxation. Mortgages upon real estate and executory

[9] *Letter,* Attorney-General Walter D. Van Riper to Dr. John F. Sly, Chairman, Commission on State Tax Policy, December 6, 1945. The complete opinion appears in Appendix A. of this report.

contract for the sale of real estate were separately taxed at a lower rate. The opinion points out that the bank share tax must be compared with the tax assessed on competing moneyed capital of individuals invested in credits, or the tax on capital invested by individuals in the shares of corporations whose business competes with that of national banks, and thus compared, there was tax discrimination within Section 5219, if moneyed capital in the hands of individuals in Minnesota is employed in substantial competition with national banks within the State. In reaching a determination that discrimination existed, the Court considered as national bank competition, the business of note brokers, promissory notes in the hands of individuals, and individuals and corporations, using substantial capital, engaged in business as investment houses dealing in bonds and mortgages.

In view of the above examination and analysis, the *Commission* is of the opinion that the following financial situations are *open to consideration* for tax purposes in giving effect to the Federal rule requiring the taxation of "other moneyed capital in the hands of individual citizens . . . coming into competition with the business of national banks":

A. *Shares of stock held by resident individuals in the following types of corporate enterprise:*
   1. Sales finance companies
   2. Personal loan companies
   3. Small loan companies
   4. Commercial paper dealers
   5. Investment brokers and dealers
   6. Mortgage loan companies
   7. Stock insurance companies
   8. Pawnbrokers and
   9. Any others engaged in the use of moneyed capital for profit by means of loans or discount, by loans on collateral security or by investment or reinvestment, which an administering authority might determine to be in substantial competition with national banks.

B. *Capital and undivided profits of:*
   1. Mutual savings banks
   2. Credit unions
   3. Building and loan associations
   4. Mutual insurance companies, and
   5. Any other unincorporated business engaged in the use of moneyed capital for profit by means of loans or discount, by loans on collateral security or by investment and reinvestment which an administering authority might determine to be in substantial competition with national banks.

In the judgment of the *Commission,* six of these can be eliminated from the proposed tax base. Insurance companies (A-7 and B-4 above) are most unlikely to fall within the required field of competition in that their investment business is primarily of a long-term nature. All insurance companies are, moreover, subject to both State and local taxes, which, in their operation, could be shown to obviate any claim of discriminatory treatment of investments in bank stocks; and in the case of mutual companies the individual holds nothing more than an evidence of debt, which is specifically excluded from consideration by *R. S.* 5219.

Depositors in mutual savings banks and shareholders in credit unions and building and loan associations (B-1, B-2 and B-3 above) are likewise the holders of evidences of debt notwithstanding that they may have some characteristics of management participation. As in the case of insurance policyholders in mutual companies, it is believed that these latter groups are also excluded by the proviso of *R. S.* 5219. Even though shares in the latter two groups (credit unions and building and loan associations) were to be considered in the nature of stock holdings, it is most unlikely that in their present development these holdings would be deemed "moneyed capital," in the sense of an equity interest, or that these types of financial business would be held to compete with national banks, under *R. S.* 5219 as applied by the courts.

A principal distinction between investment in these types of enterprise and stock equities, lies in the difference between investment for earnings and investment for capital appreciation. In the case of the mutual companies, the holders of deposits, "shares" or "memberships" are essentially engaged in safe-keeping with a moderate interest return. There is no opportunity for capital appreciation.

Stock equities, however, represent the risk-taking type of venture with the opportunity for earnings and capital appreciation through successful operation (as well as through market forces). This type of investment represents moneyed capital in the hands of the individual owners, comparable to an investment in national bank stock. Since the purpose of the equality of tax treatment has been shown to be a protection of the comparability of investment alternatives, it seems clear that the factors of capital risk and appreciation are significant guides to the scope of the phrase "competing moneyed capital."

Sufficient basis for exclusion of investments in these mutual institutions (so far as the Federal statute is concerned) may, from this viewpoint, be found in their lack of a moneyed capital

character, on the one hand, and their apparent specific exclusion as "bonds, notes or other evidences of indebtedness" on the other.

Credit unions are restricted in their loans to those who are members (shareholders). Building and loan associations are restricted in their loans to those who are "members" and to first mortgages on property used for residential purposes. National banks may and do serve the same type of borrower, and to that extent do compete for loans with these institutions, particularly with building and loan associations which are not limited to serving a particular group as are credit unions. But the scope of the competition, in all events, is limited, and it is unlikely that a court would consider their operations as substantial competition under *R. S.* 5219. As a practical matter, no state using the share method of taxing national banks, has deemed it necessary to tax mutual institutions under the competing moneyed capital requirement.[10]

The remaining classes of business enterprise listed above (with the exception of pawnbrokers whose customers, loans and collateral are generally outside the banking business) appear to be sufficiently competitive with national banks to warrant their inclusion in any revision of the present total exemption. *R. S.* 5219 might not technically require the inclusion of some of them in order to conform New Jersey statutes to its limitations. From the standpoint of State tax policy and equality of treatment, however, it would appear desirable to place all business employing moneyed capital upon the same tax basis, where there is no distinctive characteristic to warrant classification, and where "public policy" has not decided otherwise.

The *Commission* has been forced to the conclusion that the application of the Federal rule as it applies to "business in competition with national banks," establishes, under modern business practices, a standard which must refer to the credit market generally if it is to be administered in a practical way. It would be difficult to show that any single business, except another bank, comes into direct competition with a national bank. There is no more a single business in substantial competition with a national bank, than there is a single business in substantial competition with a grocery store. It is true that tax equality requires that there be no more discrimination as between financial businesses than there should be as between retail businesses. But tax equality cannot be related to the *degree of competition* of a single business but only to the common characteristics of the businesses which

[10] See The Tax Research Foundation, *Tax Systems*, Ninth Edition (Commerce Clearing House: New York, January 1942) pp. 186, 192, 193-198.

form the base of the tax. The truth seems to be that national banks compete substantially with many businesses, including the whole credit market in which they operate. That is to say, a quantitative definition of competing business is not practical, but the quantitative treatment of *capital* employed in competition is a practical measure.

From the standpoint of the importance of a particular type of banking business to the total banking business, it may well be that the reason national banks have not obtained a larger share of a particular type of business is the very existence of substantial non-banking moneyed capital which seeks (and obtains) the same type of business. This view seems implicit in the controlling Supreme Court cases. A long line of the court's decisions has sought to protect national banks from discriminatory taxation by defining their competitive positions, under a financial structure that would have astonished the framers of the original amendment of 1864 to the National Bank Act. It is nevertheless necessary for the *Commission* to select single businesses or groups of businesses to form a tax base under the competitive requirements of *R. S.* 5219. The *Commission* has accordingly based its selection upon a vague line formed by "the facts of each case"—the basis of judicial decisions—estimates of the amount of capital employed by "competing businesses," the testimony of those with whom it has consulted, and upon its own experience and knowledge of modern business practice. The *Commission* concludes, accordingly:

> I. That the Following Financial Institutions Considered as a Group, Represent Substantial Moneyed Capital in Competition With National Banks Within the Intent of R. S. 5219 and Should be Removed From the Present Exemption in Order to Satisfy the Requirements of the Federal Rule:
>
> A. *Shares of stock in the following types of corporate enterprise:*
>
> 1. Sales finance companies
> 2. Personal loan companies
> 3. Small loan companies
> 4. Commercial paper dealers
> 5. Investment bankers and brokers dealing in Governments and municipals
> 6. Mortgage loan companies
> 7. Any others engaged in the use of moneyed capital for profit by means of loans or discounts, by loans on collateral security, or by investment and reinvestment which the administering authority determines are in substantial competition with the business of national banks.

B. *Capital and undivided profits of:*

Any *unincorporated* business engaged in the same kind of activity as any of the foregoing corporate types, or generally, in the use of moneyed capital for profit by means of loans or discounts, by loans on collateral security, or by investment or reinvestment, which the administering authority determines is in substantial competition with national banks.

Provided, that moneyed capital employed in the following businesses shall not be deemed to be included:

1. Stock insurance companies
2. Mutual insurance companies
3. Credit unions
4. Mutual savings banks
5. Building and loan associations, and
6. Pawn brokers.

Nor shall bonds, notes, or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with such business, be deemed to be moneyed capital for the purposes of the proposed tax.

Incidence and Measure

Following the above determination of the tax base, the *Commission* turned its attention to the type of tax structure most likely to be effective under the Federal requirements and which would, at the same time, best fit the requirements of New Jersey practice. *R. S.* 5219 permits four alternative methods of taxing national banks. The provision reads:

> "The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income. . . ."

It will be observed that the alternatives under the Federal rule present three types of income taxes and a property tax on shares. In regard to the income tax alternatives, the *Commission* can only repeat the words of the *Commission on Taxation of Intangible Personal Property* that "It is not possible to tax business activity with satisfactory fairness without giving consideration to its earnings. The *Commission* has been assured on every hand that this is

politically impossible, and the members, themselves, are well aware of the public resistance to anything that resembles an income tax or even an income factor in a tax formula."[11] For this reason, the income tax alternatives provided under the Federal law have been rejected, and the *Commission* gave its attention to the fourth alternative—a property tax on shares.

There is a fundamental choice to be made as between placing primary responsibility for the tax directly upon the competing business units, or levying the tax to individual shareholders or owners. In the latter case, there is the further choice of whether or not to place collection responsibility upon the business unit.

The object of the tax is capital used in competition with that of national banks in New Jersey. But shareholders of competing corporations may live outside of New Jersey and their shares may be untaxable by virtue of being located out of the State. In such an instance, the shareholder owns a security which is not located in New Jersey for tax purposes but which represents capital employed in New Jersey from a competitive viewpoint. Thus the choice as between a tax assessed against a corporation using capital in competition with national banks and a tax against the shareholders of that corporation is more than simply a matter of convenience.

The *Commission* has already expressed its views in opposition to a property tax upon intangibles held by individuals. The choice between a property and an income tax upon competing moneyed capital as permitted by Federal law is, from New Jersey's standpoint, more apparent than real. Whatever the merits of either method may be, the *Commission* is well aware that New Jersey is not at present inclined to consider a tax on or even measured by income. The bank stock tax, moreover, is on the bank shares *as property,* and an income tax on competing moneyed capital would fail to meet the Federal requirement, unless banks were similarly taxed. In spite of the *Commission's* reluctance to tax intangibles as property, New Jersey practice and the Federal rule seem to limit the *Commission* to consideration of the "true value" of competing moneyed capital as a measure of the required tax within this limited field of intangible personalty.

The difficulties of a property tax on intangibles held by individuals, to which we have adverted on several occasions (see *Letter of Transmittal,* p. xi *et seq.*) would be only partially relieved by provision for collection of the tax from the competing business entity. A related feature of the present bank stock tax

[11] *Report* (March 26, 1945), p. 79.

has operated satisfactorily only because it deals with localized institutions[12] and the banks have almost universally exercised their option to assume direct liability for the tax which is theoretically on the shareholders. At the least, it is doubtful whether a foreign corporation could be compelled to pay the tax on its shareholders in the absence of any dividend accruals.

Constitutional limitations on the State's jurisdiction to tax shares of stock held by individuals must also be recognized. The State may tax these as property either 1) at the domicile of the owner; or 2) at the domicile of the corporation; or 3) at the business situs, if any, of the shares. The last of these alternatives, business situs, is not involved at this point.

A tax imposed with reference to the domicile of the owner would mean that large financial corporations which compete substantially with banks in this State but have few, if any, stockholders resident here, would escape a fair share of the tax. A tax on the shares imposed at the domicile of the corporation, on the other hand, would be effective against domestic corporations, but ineffective against foreign corporations. Here again equality of tax treatment of the competing business would be defeated by failure to include the principal competing units, foreign corporations, in the tax base.

The individual employs capital in and through the corporation. A tax measured by such capital or its use is difficult to assess against any taxpayer other than the corporation. The shareholder whose property interest is in the form of capital stock is difficult to identify, may readily evade assessment and, in the case of competing foreign corporations, may be beyond the taxing jurisdiction of the State. A tax upon the corporation would obviate these difficulties. Since a tax directly to the corporation is paid out of earnings which ultimately belong to the shareholders, the legal distinction between a tax against a corporation and a tax against the shareholders could still be recognized in defining the measure of the tax.

For the reasons stated, the *Commission* is of the opinion that it would be desirable to tax competing moneyed capital by assessment directly to the competing business unit. In considering such a procedure, the *Commission* is not unaware of the implications of *R. S.* 5219, and the possibility that the language of the Federal

[12] That is, State banks and trust companies which are domestic corporations, and national banks, which may employ their capital only within the State and for which Federal law makes the shares assessable at the place where the bank does business.

law may not authorize a tax assessed other than to the individual residents of the State.

The Federal law states the tax on "said shares" (of national bank stock) may not be at greater rate than is "assessed *upon other moneyed capital in the hands of individual citizens of such State* coming into competition with the business of national banks. . . ." The Federal statute goes on to provide:

> "2. The shares of any national banking association owned by non-residents of any State shall be taxed by the taxing district or by the State where the association is located and not elsewhere; and such association shall make return of such shares and pay the tax thereon as agent of such non-resident shareholders." (12 *U. S. C. A.* sec. 548).

So far as a property tax is concerned, the Federal statute, in specific language, seems to imply that the tax should be on capital "in the hands of individual citizens of such State" and again, to the same effect, in the quoted provision that the national banking association may be assessed "as agent of such nonresident shareholders." *R. S.* 5219, in providing by express mention two income tax alternatives of taxing the associations, with reference to comparable taxes assessed directly to other business corporations, might also impliedly exclude any other types of taxes assessed directly to competing business units. In any event, it has already been observed that the incidence of a tax upon competing corporations must, of necessity, be very different from the incidence of a tax on their shareholders.

In view of these doubts, the *Commission* requested an opinion of Attorney-General Van Riper. The question and the opinion of the Attorney-General on this aspect of the matter are as follows:

> QUESTION: Does the phrase "other moneyed capital in the hands of individual citizens" require that a comparable tax be assessed to the individual shareholders in a competing business, or may the requirements of the Federal statute be met by a tax measured by the value of capital stock and assessed to the competing corporation directly?
>
> ANSWER: In answer to your inquiry . . . I am of the opinion that the requirements of the federal statute may be met by a tax assessed to the competing corporation directly, *Amoskeag Savings Bank* vs. *Purdy*, 231 U. S. 373; *State of Minnesota* vs. *First National Bank*, 273 U. S. 561; *Montana National Bank* vs. *Yellowstone County*, 276 U. S. 499; *Iowa, Des Moines National Bank* vs. *Bennett*, 284 U. S. 239; *Commissioner, etc.* vs. *Woburn*, 53 N. E. 2d 554 at 558.

These practical and legal conclusions are further supported by the experience and practice in other States. In a study completed for the New York State Tax Commission some twelve years ago, when banking practice was much more conservative than it is today, it was found that substantial competition from various newer forms of financial business was taxed by levies directly upon the competing units. These observations are summarized as follows:[13]

> "In recent years many types of financial institutions have sprung up to compete with commercial banks in certain phases of their business, as well as to take over other financial operations which have been considered beyond the pale of conservative banking. Among these institutions, which one writer has called 'quasi-banks,' are investment bankers, finance companies, mortgage loan companies, commercial paper houses, small loan companies, and investment trusts.
>
> "These corporations, while generally not permitted to receive deposits, secure funds by highly analogous methods such as selling demand notes, debentures and preferred stock in convenient denominations or on the instalment plan. Common stock is sometimes sold with the understanding that it will be bought back at any time at a fixed price. Thus these concerns are able to offer some competition to banks in the securing of funds. Of more significance, especially from a legal standpoint, is their competition in the lending of funds. While each type of institution has its peculiar function, there exists a considerable amount of overlapping of services.
>
> . . .
>
> "Many states include certain of these types of financial corporations within the taxing statute applicable to banks, and trust companies. Industrial or Morris-plan banks are quite generally so included. Minnesota, Kentucky and North Carolina, extend the bank tax to mortgage loan companies, and Kansas and Maryland, to finance companies. But most States have not adapted their tax systems to the somewhat sporadic growth of new institutions. In these States the general tax laws must be relied upon until such time as the Legislature see fit to remedy the situation.
>
> "There is no uniformity among the States in the taxation of these institutions. Most commonly they are taxed upon their gross or net assets or upon their taxable assets and corporate excess. . . .
>
> "In addition to these property taxes, financial institutions may be subjected to a business tax. Indiana taxes foreign finance companies on 'gross transactions' at the rate of one-half of one per cent. Finance companies are subject to a flat license tax in Georgia and a graduated

[13] New York State Tax Commission, *Special Report No.* 7 (Albany, 1934), by Ronald B. Welch, "State and Local Taxation of Banks in the United States," pp. 201-203.

tax in Mississippi. In North Carolina they are taxed at the annual rate of one per cent upon 'the face value of paper dealt in, bought, and/or discounted.' In practically all States general business taxes on invested capital or net income apply to miscellaneous financial corporations.

"The experience thus far recorded by those close to the operation of these laws affords little guidance to sound tax policy in this field. On the surface there is no good reason why these corporations should not be taxed on the same basis as commercial banks. From a legal standpoint, any other method of taxation is of somewhat questionable validity unless it is clearly heavier than the tax on national banks. But even with the same tax base, certain inequalities may arise. New lines of enterprise are less subject to the leveling forces of competition and less restricted by law than the long established business of banking. Hence, investors may realize large profits on investments in such lines, and taxes upon the book value of assets or shares may be comparatively light as measured by income."

The *Commission,* having reviewed the practical advantages, legal requirements and comparable laws, recommends:

II. That Competing Moneyed Capital Employed in the Classes of Business Outlined above should be Taxed Directly to the Competing Business Unit.

* * *

The measure of the tax on competing moneyed capital follows readily from the proposal to tax the business units directly. To parallel the bank stock tax, competing corporations should be assessed upon the value of their capital stock (which may be expressed as net worth) employed in competition in New Jersey.

Capital stock value as a measure of the proposed tax, excluding for the moment out-of-State employment of capital, would be defined in the same manner as now provided for the bank stock tax. This is accomplished as follows:

"54:9–2. The shares of the common capital stock of banks, as defined in section 54:9–1 of this Title, shall be assessed and taxed according to their true value, to be determined in accordance with the provisions of sections 54:9–4 and 54:9–9 of this Title."

"54:9–4. The value of each share of common stock of each bank shall be ascertained and determined by adding the amount of its capital, surplus and undivided profits and deducting therefrom the assessed value of its real property, including in such deduction the assessed value of all real property owned by a corporation all the stock of which corporation is owned by such bank, . . ."

"54:9–9. Each county board of taxation shall annually, on January fifteenth, ascertain from an inspection of the statements filed, and from any other sources of information which may be open to it:

"a. The names and places of business of all banks in the county;

. . .

"f. The assessed value of its real property, and the assessed value of all real property owned by a corporation all of the stock of which is owned by such bank;

"g. The true value of all the common capital stock of each issued and outstanding;

. . .

"i. The amount of tax levied upon the common capital stock of each at the uniform rate."

* * *

It will be noted that preferred stock is exempt from assessment under the present bank stock tax. This rule obviously creates an unjustified inequality in taxation among banks themselves. This exemption is required, to the extent that such preferred stock is held by the Reconstruction Finance Corporation, by an Act of Congress overruling a contrary decision in *Baltimore National Bank* vs. *State Tax Commission of Maryland.*[14] The exemption is not believed, however, to extend to tax assessed to the bank directly on or according to or measured by its net income (the third or fourth alternatives under *R. S.* 5219). But an income tax appears to be excluded from consideration and a tax on capital stock assessed to the bank directly is not permitted under Federal law.

The *Commission* accordingly recommends:

III. That Banks and Trust Companies with Preferred Stock Outstanding be Limited to the Deduction of Such Preferred Stock as is Held by the R. F. C.

* * *

The use of capital stock value (or net worth) as a measure of the proposed tax, commonly employed in some of the older corporate franchise and property taxes, such as in Pennsylvania, is not deemed by the *Commission* to offer an entirely satisfactory tax base. It has two advantages in that it provides the closest possible base to the bank stock tax and also parallels the Corporation

[14] 297 U. S. 209, 56 Sup. Ct. 417 (1936). Subsequent to this decision, the RFC tax exemption section was amended by adding the following language: ". . . Such exemptions shall also be construed to be applicable to the loans made, and personal property owned, by the Reconstruction Finance Corporation or by any corporation referred to in clause (1), (2) or (3) of the preceding sentence, but such exemptions shall not be construed to be applicable in any State to any buildings which are considered by the laws of such State to be personal property for taxation purposes." (As amended June 10, 1941, c. 190, §3, 55 Stat. 248.)

Business Tax Act (1945) which uses net worth as its measure. The proposal also has the determining advantage of restoring equality of tax treatment as between national banks and competing moneyed capital in a way which will satisfy *R. S.* 5219.

Beyond this, the *Commission* might well repeat the observation of its predecessor, the *Commission on Taxation of Intangible Personal Property:*[15]

> "The *Commission* realizes the limitation of the above proposal, but it wishes to emphasize this point: The ownership of corporate property is only a remote measure of corporate ability to pay taxes. So long, therefore, as property is the base of the tax, so long will there be inequalities in its application. It is not possible to tax business activity with satisfactory fairness without giving consideration to its earnings. The *Commission* has been assured on every hand that this is politically impossible, and the members, themselves, are well aware of the public resistance to anything that resembles an income tax or even an income factor in a tax formula. For this reason, any reference to earnings in the formula has been carefully avoided, and the property tradition maintained as the basis of the tax. Because net worth reflects net corporate ownership, it more nearly reflects an equitable property tax base than do property holdings."

Unincorporated business units engaging in the same type of competitive business as the corporations already discussed could not, of course, be reached through a tax measured by capital stock. A comparable measure would be capital and undistributed profits. If the tax were to be imposed in the form of a property tax, however, it would probably be necessary to provide for deduction of Federal Government securities, which are constitutionally immune from taxation by the States. The Supreme Court has held in *Des Moines National Bank* vs. *Fairweather*[16] that such an exemption would not destroy the effectiveness of the tax under *R. S.* 5219.

A similar condition would arise with respect to the tax assessed to competing corporations. In either case a property tax assessed to the business unit would require the allowance of a deduction from net worth of the value of Federal securities. But such a deduction would inevitably operate to induce taxpayers to go into Governments at tax time. It also would have an unequal effect, depending upon the composition of individual investment portfolios. A more equal application of the tax would result from the use of an excise tax in respect of business done measured by the

[15] *Report* (March 26, 1945) p. 79.

[16] 263 U. S. 103, 44 Sup. Ct. 23 (1923).

value of capital stock, in the case of a corporation, and by capital and undistributed profits, in the case of an unincorporated unit, employed in doing business in New Jersey.

Some adjustment of this will be required to meet special situations. One of these arises where financial businesses have large stock holdings in corporations which are specially taxed under New Jersey laws. This is particularly true of equity holdings in insurance companies and banks. Other such holdings represent equities in financial businesses which will become taxable under the *Commission's* recommendations. The argument has been advanced that such holdings should not be considered as part of the new tax base because their inclusion would constitute double taxation, at rates very much greater than those imposed on general business corporations, upon that part of the taxpayer's capital which they represent.

National banks are prohibited from purchasing for their own account the shares of stock of any corporation.[17] This means that the problem of double taxation from this source does not arise in the case of banks, and that it is essentially one concerning only competing financial businesses. The *Commission* concludes that, under such conditions, provision for a deduction from net worth of property specially taxed in New Jersey—i.e., shares of stock of insurance companies, public utilities, railroads, banks and other financial businesses—is warranted. To parallel the bank stock tax, it would also be necessary to permit a deduction of the assessed value of real estate taxable in New Jersey, but not more than the taxpayer's equity in such real estate.

The New Jersey Corporation Business Tax Act (1945) provides for relief from double taxation, in the case of subsidiaries, by allowing a deduction to the parent corporation up to 50 per cent of the amount of subsidiary capital as follows:[18]

> "Any taxpayer which holds capital stock of a subsidiary during all or part of any year may, for the purposes of the tax imposed by this act, deduct from its net worth such proportion, not exceeding fifty per centum (50 per cent), of the average value of such holdings less net liabilities (if any) to subsidiaries, as the ratio of the subsidiary's taxable net worth, for the same year under this act, to its entire net worth. . . . For the purpose of this section, a subsidiary shall be deemed to be any corporation in which a taxpayer is the beneficial owner of at least eighty per centum (80 per cent) of the total combined voting power of all classes of stock entitled to vote and of at least eighty

[17] See note 6, *supra*.

[18] New Jersey Laws 1945, Chapter 162, Sec. 9.

per centum (80 per cent) of the total number of shares of all other classes of stock except nonvoting stock which is limited and preferred as to dividends."

The *Commission* believes this is a proper deduction and that a similar deduction from net worth should be allowed financial businesses to the extent that they hold subsidiary capital which is taxed under the New Jersey Corporation Business Tax Act or under the proposed new act. However, subsidiary capital which is not taxed in New Jersey enters into the assets and the net worth of the business in the same way as do other assets and is subject to the same allocation formula.

The *Commission* accordingly recommends:

IV. That the Tax on Competing Moneyed Capital Take the Form of a Financial Business Excise Tax Measured by Capital and Undistributed Profits Employed Through Unincorporated Business Units and by the Value of Capital Stock Employed by Corporations, with Deductions for the Assessed Value of Real Estate in New Jersey, for the Value of Intangible Personalty Specially Taxed, and for Further Relief from Double Taxation to the Extent (up to 50 Per Cent) that Subsidiaries Are Already Taxed in This State.

* * *

Apportionment of Tax Base

The application of the proposed capital stock tax to corporations of this and other states requires a method of identifying that portion of the capital value to be used as a measure of the tax. This problem has not arisen in the bank stock tax for the reason that banks are not authorized to maintain a place of business outside the county of their principal office. It need hardly be noted that competing moneyed capital is not so restricted, and in fact, corporations which may and do operate on a national basis are a principal source of competition. Both tax law and sound policy require that this characteristic of the competing business be recognized in the proposed legislation.

The selection of a method of allocation depends upon the type of tax with which it will be used. If the proposed tax were deemed

to be a property tax, the matter of allocation would be reduced to the simple proposition that the State may constitutionally tax only such property as may be found within the State. Such situs determination for the purposes of a capital stock tax would at least find deductions for all tangibles located outside the State, for all Federal government securities (as immune from taxation) and for all other items of property (e.g. municipal obligations) which State policy might desire to leave free of a capital levy. These deductions would apply to a domestic corporation. Foreign corporations could be subject to a measure including only that proportion of their capital employed within the State.

Under an excise tax measured by capital, as proposed, there is considerably more freedom to achieve a working equality of treatment as among the various classes of taxpayers, foreign and domestic corporations and unincorporated business. In the State's general business tax—what is known as "the corporate net worth tax"—there are similar considerations and the so-called Massachusetts formula was adopted. This formula allocates by using an average of three factors, payroll, tangible property, gross receipts, in and out of the State. In the case of a business where one or more of these factors may be practically inapplicable, it may be omitted. Financial business is a principal instance of this kind.

It is inherent in financial business that neither payroll nor tangible property should ordinarily be relevant factors in a determination of the location or amount of capital employed. The Supreme Court has clearly described the business involved for present purposes as all enterprise in which the capital employed is money, where the object of the business is the making of profit by its use as money, such as investment and reinvestment in securities by way of loan, discount, or otherwise, loans on collateral security, negotiation of loans, either as an instrument of a permanent character or temporarily with a view to sale or repayment and reinvestment.

It is apparent from this definition that either the average amount of loans and discounts placed through New Jersey offices (as compared with the amount everywhere) or the gross business done through New Jersey offices (as compared with the gross everywhere) would be a satisfactory measure of the employment of competing capital in this State.

Thus, a national corporation which has a total of $5 million in loans outstanding and which has four offices in New Jersey with total outstandings of $500,000 might allocate 10 per cent of its

total capital, surplus and undivided profits to New Jersey. This 10 per cent of the total which is allocated to New Jersey would in turn be allocated as among the four New Jersey offices according to the amount of loans outstanding of each of them.

Outstandings might not be satisfactory, however, to allocate capital of an investment company which may deal partly in stock equities and partly in Governments and municipals. For this type of company, gross business might be a more practical measure of allocation. It could be defined as the sum of:

1) Fees, commissions or other compensation for financial services rendered within this State.

2) Gross profits from trading in stocks, bonds or other securities managed within this State.

3) Interest and dividends received on loans, stocks, bonds and other securities managed within this State.

4) Interest charged to customers, at places of business maintained within this State, for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts.

5) Any other gross income resulting from the operation of financial business within this State.

divided by the aggregate amount of such items of the taxpayer everywhere.

The advantage of a single formula, reasonably related to turnover of capital in New Jersey, as compared with the possible use of outstandings, seems to justify the somewhat more complicated gross business basis. The *Commission* accordingly recommends:

V. That Capital Employed be Allocated in Proportion to Gross Business Done in New Jersey, as Herein Defined.

Rate and Yield

In the *Commission's* judgment, there are only two definite conditions affecting the rate:

First: It must be set so that competing moneyed capital will not be assessed at a lesser rate than shares of stock in national banks (*R. S.* 5219).

Second: If the broadening of the tax base is to be accompanied by any uniform rate less than the present 7.5 mills on bank stock, the yield of the tax on all financial corporations must at least equal the amount anticipated by each county and its municipalities for 1946 from the bank stock tax.

Within these rather uncertain criteria, the selection of a rate to be applied to competing moneyed capital suggests a re-examination of the 7.5 mill rate. This rate may be excessively high as compared to taxation of similar business in other states and it is quite clear the rate is already greatly in excess of that imposed on general business corporations in New Jersey.

General corporate business is now taxable under the Corporation Business Tax Act (1945) at 8/10 of a mill upon that part of its net worth allocated to the State. As compared to this rate, banks are taxable under the bank stock tax at 7½ mills upon what amounts to virtually the same base (capital, surplus and undivided profits). Thus, the rate of the bank stock tax is more than nine times that of the corporate business tax.

There are several reasons of policy which justify a higher rate for banks; but these reasons are not all appropriate to other financial corporations. For example:

1) Both taxes are "in lieu" of taxation of intangible personal property. While the bank stock tax is also "in lieu" of taxation of what little tangible personal property is held by banks, general business corporations remain subject to relatively heavy assessments on inventory, machinery equipment and other tangible personalty, at the general property tax rate.

2) The assessed valuation of real estate taxable in New Jersey is deductible from capital, surplus and undivided profits under the bank stock tax, but no similar deduction is allowed from the base of the general corporate business tax.

3) General business corporations usually require a much greater net worth for a given volume of business than a bank, which may do business soundly on a ratio of capital to total assets of only 10 per cent or less.

4) Banks are a business affected with a public interest in that they enjoy the valuable privilege of soliciting and accepting deposits—a privilege not conferred upon any other business.

All but the fourth and to a lesser extent the third of these points are equally applicable to financial corporations. By comparison with rates assessed upon bank shares in other States moreover, it appears that the New Jersey rate of 7.5 mills (¾ of 1%) falls among the more moderate levies. When compared with the taxation of life insurance companies at approximately one-half the general property rate (beginning in 1951) which in Newark may mean one-half of $6.00 or 3 per cent on capital and surplus, the bank stock tax appears moderate indeed. It would thus be difficult

to justify any very substantial reduction in this rate, except as it may appear excessive with respect to competing financial business.

It is quite common in classified property tax states to tax intangibles at 2 or 3 mills. Such a tax may extend to the total assets of certain financial corporations, and is generally accepted as a reasonable levy. Assuming a 3:1 ratio of assets to net worth for this type of business, a tax ranging from 6 to 9 mills on net worth would develop a tax liability equivalent to the 2 or 3 mill rate on intangibles. From this viewpoint, the 7.5 mill rate on net worth would compare favorably with taxes elsewhere, and could not be said to be unduly burdensome.

The problem of establishing a suitable tax rate under the circumstances thus suggests an incidental source of revenue for the two levels of government now receiving the bank stock tax. The *Commission* is cognizant of the need to relieve real estate, and anticipates some incidental revenue from the new tax base which may be applied to this end.

The determination of the tax rate is, however, complicated by special conditions which characterize the business of financial institutions. The ratio of assets to net worth in banks and in other financial businesses varies greatly. In personal loan companies this ratio rarely exceeds 3 to 1, while in the case of banks it may be as high as 10 to 1 or even 20 to 1. To apply the same rate to a tax base that varies so widely in terms of its financial resources would seem to place a disproportionate burden on the assets of the business with a low ratio of assets to net worth.

As shown in Table 4, the net worth (capital, surplus and undivided profits) of personal finance companies in 1943 averaged 62 per cent of total assets as compared with 7 per cent for banks in New Jersey. A tax at 7.5 mills upon net worth in 1943 would be the equivalent of a tax at 4.65 mills on the total assets of personal finance companies and a tax at 0.525 mills on the total assets of banks. This means a tax at uniform rates upon net worth would be the equivalent of a tax upon assets of personal finance companies about nine times what it would be upon the assets of banks. In 1941 the effective tax rates upon the assets of personal finance companies would have been about six times the effective rate upon the assets of banks. This condition arises from the fact that banks obtain a large portion of their funds from deposits while personal finance companies operate to a much larger extent upon equity capital. Decreased volume of consumer credit outstanding during the war caused finance companies to retire their debts and thus increase their ratio of assets to net worth.

TABLE 4

NET WORTH AS PER CENT OF TOTAL ASSETS

FOR

FINANCE COMPANIES AND NEW JERSEY BANKS

(1939-1943)

Institutions	*1939*	*1940*	*1941*	*1942*	*1943*
1. Commercial credit and finance companies[1]	28.5	21.7	18.5	37.2	48.1
2. Personal finance companies[1]	56.3	53.2	48.6	54.8	62.3
3. New Jersey banks:[2]					
a. Trust companies	11.2	10.5	9.8	8.5	7.2
b. State banks	9.1	7.8	7.9	7.6	6.5
c. National banks	10.8	10.4	9.7	8.5	7.4

[1] Computed from data published by Securities and Exchange Commission, *Survey of American Listed Corporations, Balance Sheet Data,* Survey Series Release No. 88. Data include nineteen commercial credit and finance companies for 1939 and 1940 and twenty companies for 1941-1943. They include ten personal finance companies for 1939, 1940 and 1943 and eleven companies for 1941 and 1942.

[2] Computed from data published by New Jersey Commissioner of Banking and Insurance, *Annual Reports* 1939-1943.

In recognition of these differences, it has been suggested to the *Commission* that competing financial businesses be taxed at a lesser rate than banks or that a ceiling be placed upon the total taxable net worth of the taxpayer, which shall not exceed a stated per cent of its total assets.

As shown in Table 5, however, banks earn less on their assets than do other financial businesses. Personal finance companies realized operating profits in 1941 equal to about 8 per cent of their total assets, or about nine times the 0.9 per cent realized by commercial banks. This indicates that a tax measured by net income in 1941 would result in the equivalent of a tax upon the assets of personal finance companies about nine times what it would upon banks (instead of six times as in the case of a net worth tax). In 1941 the "asset tax equivalent" of an income tax would thus be less favorable to personal finance companies as compared with banks than would that of a net worth tax. Available data indicate that this condition is general.

TABLE 5

OPERATING PROFIT OF SELECTED SAMPLES OF CONSUMER INSTALMENT FINANCING AGENCIES AND COMMERCIAL BANKS IN PER CENT OF TOTAL ASSETS, 1936-41[1]

Sample	*1936*	*1937*	*1938*	*1939*	*1940*	*1941*
Sales finance companies						
2 to 3 national[2]	6.0	5.3	4.6	4.2	3.5	3.2
2 to 4 regional[2]	6.7	5.5	4.0	4.4	4.0	3.3
9 to 32 local[2]	6.8	6.6	4.2	4.7	4.6	4.6
202 local[3]	5.6	..	..	..	..	..
Personal finance companies						
2 national[4]	10.4	10.8	9.5	9.2	8.6	7.3
2 to 5 regional[4]	11.0	11.5	8.9	9.2	9.2	8.1
5 to 7 local[4]	10.6	9.7	7.2	7.9	9.5	8.1
153 local[3]	7.3	..	..	..	..	..
79 non-invest. type indust. bkg. cos.[3]	5.2	..	..	..	..	..
Invest. type indust. banks						
56 noninsured[3]	2.8	..	..	..	..	..
6 largest insured[5]	3.4	3.2	3.7	3.3	2.8	2.6
All other insured[5]	4.0	4.3	3.5	3.7	3.0	3.0
37 insured[3]	3.3	..	..	..	..	..
Credit unions						
All reporting federal credit unions[6]	4.3	5.1	5.0	4.9	4.9	4.3
Commercial banks						
All national banks[7]	1.5	1.2	1.1	1.1	.9	.9
All insured banks[5]	1.4	1.1	1.0	1.0	.9	.9

[1] Operating profit designates the amount of profit after the payment of all costs except the cost of borrowed funds.

[2] Based on data from the National Credit Office, Inc. Some of these companies are included in the 202 local companies of the income tax sample. Here the denominator is the average of total assets at the beginning and end of year.

[3] Based on tabulations prepared by the Income Tax Study. The figures represent operating profit in per cent of year-end assets.

[4] Based on data from the National Credit Office, Inc. Some of these companies are included in the 153 local companies of the income tax sample. Here the denominator is the average of total assets at the beginning and end of year.

[5] Based on data from Federal Deposit Insurance Corporation. Total assets are averages of figures for beginning, middle and end of year; deposits accumulated for the repayment of loans have been deducted from total assets of industrial banks. Cash depositories and banks designated in this study as insured industrial banks are included with all insured commercial banks.

[6] Data obtained from U. S. Farm Credit Administration, Division of Finance and Accounts. The figures represent operating profit in per cent of year-end assets.

[7] Based on data in Annual Reports of the Comptroller of the Currency. Total assets are averages of figures for call dates during the year.

SOURCE: Ernest A. Dauer *Comparative Operating Experience of Consumer Instalment Financing Agencies and Commercial Banks*, Financial Research Program, Studies in Consumer Instalment Financing of the National Bureau of Economic Research (New York, 1944) p. 129.

The relative impact as among taxpayers of a tax measured by one base is seldom the same when expressed in terms of another base. All businesses do not hold the same kinds and amounts of assets; they do not finance themselves in the same way; they do not do the same things; and they do not realize the same earnings. Individually or in combination, all of these things and the relative position of individual taxpayers under the tax will vary accordingly.

If one common measure of equity is to be applied to all taxes, income and not total assets seems most adaptable to this purpose. In terms of income, there seems no basis for providing a tax differential in favor of finance companies as against banks.

In addition to considerations of economic differences as among different financial businesses, there is the matter of providing a tax which will meet the requirements of the Federal Statute. A tax upon only a portion of the net worth or capital of a financial business amounts to the same thing as a tax at a lesser rate upon all of the net worth or capital of that business. Such a tax would thus be vulnerable to attack under the Federal requirement (*R. S.* 5219) that:

> "In the case of a tax on said shares (the shares of a national bank) the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks."

The *Commission* concludes that there is no sound basis for extending a lower rate to competing financial businesses or placing a ceiling upon the total net worth of the taxpayer and that such a ceiling would endanger the validity of the present Bank Stock tax. The *Commission* therefore recommends:

> VI. Retention of the Bank Stock Tax Rate of 7.5 Mills Upon Taxable Capital, Surplus and Undivided Profits, and the Extension of the Same Rate to Competing Businesses.

The *Commission* believes that, on the basis of incomplete data available, such a rate would accomplish these results:

> 1) Applied to a tax base broadened to include financial businesses not now subject to the bank stock tax but in substantial competition with national banks, it will produce, in addition to the present bank stock tax, revenue, at least equal to the sum of:

a) the present tax upon tangible personal property of competing financial business, which will become exempt from local property taxes.

b) the amount of corporate business tax which would otherwise be paid by financial corporations brought under the tax.

2) It should afford a slight measure of tax relief to real estate in those counties in which competing financial business is concentrated.

The Yield of the Tax

The *Commission* has been handicapped by an almost complete absence of quantitative data with which to estimate the potential tax yield from the broadened tax base. However, in making its recommendations, the *Commission* has felt that the new base should produce *at least* as much tax revenue as is now derived from the taxpayers who come under it.

Records are not available to indicate the amount of local property taxes which financial businesses now pay upon their tangible personal property. However, this kind of property is not held in large amounts and the *Commission* estimates that taxes upon it do not total as much as $100,000 for the entire State. There has not yet been a year's experience under the corporate business tax and the amount of tax which financial corporations will pay under it is not known. It is certainly clear, however, that financial corporations which come under the supplement to the bank stock tax will be required to pay substantially more to the counties than they would be required to pay to the State under the Corporation Business Tax Act. The excess will more than replace any revenue loss from tangible personalty.

The present bank stock tax base produced tax revenue totaling $1,119,400 last year. The 1945 tax was based upon capital, surplus and undivided profits reported as of the end of 1944. Based upon comparisons between published bank reports for 1944 and 1945, the *Commission* estimates that the 1946 tax base will be about 10 per cent above that of 1945. This means an additional small increase in county and municipal receipts from this source.

Broadening of the tax base to include sales finance companies, personal loan companies, mortgage loan companies, commercial paper dealers and other financial businesses in competition with national banks will result in substantial increases in the aggregate tax revenues of some counties and municipalities from financial business. The *Commission* estimates that 115 small loan licensees

alone would pay taxes amounting to about $97,000 upon their capital, surplus and undivided profits as reported to the Commissioner of Banking and Insurance as of the end of 1944.

No satisfactory data are available to estimate the amount of capital employed or loans outstanding by sales finance companies, personal finance companies (other than small loan licensees), commercial paper dealers and others. For this reason, no estimate of the probable tax yield from these sources can be made. From scattered information at hand, however, the *Commission* finds that the principal tax revenues from these groups will arise from the activities of a relatively small number of taxpayers.

The *Commission* accordingly recommends:

VII. That no Specific Yield of the Proposed Tax be Anticipated for the Current Year in County and Municipal Budgets, Although Substantial Revenue, Comparable to the Bank Stock Tax, may be Realized.

Administration and Distribution

At the present time the bank stock tax is assessed by the County Boards of Taxation and collected by the County Treasurer. In practice, the tax has been self-assessed by the banks. The measure of the tax is clearly defined in terms of capital, surplus and undivided profits and these are readily determined from bank statements. Record keeping of banks is of a high order and their financial statements are available to the public. There has been no problem of allocating the tax base as among taxing jurisdictions and administration of the tax has been simple.

Recommendations of the *Commission* contemplate a somewhat more complex administrative problem. Some of the new taxpayers operate in several states and in several jurisdictions within New Jersey. This means the task of administering the tax legislation supplementing the bank stock tax may involve the securing of suitable tax returns, including provision for allocation of capital, surplus and undivided profits. Some of the subject taxpayers have not been accustomed to disclosing their financial condition as freely as banks have been, and they may raise auditing problems.

The *Commission* has been assured, moreover, that the financial businesses themselves would prefer to deal with a single tax authority rather than with a variety of local administrations. The requirements of uniform treatment as among counties, the avoid-

ance of the old problem of "tax lightning," and the necessary complexity of allocation requirements, seem to point conclusively to State administration as the most effective method. The machinery is already established and operating in the Department of Taxation and Finance to administer the Corporation Business Tax Act of 1945, and the small additional burden that the proposed tax would require, could quite likely be absorbed in the present operation. The distribution of the receipts would, however, be the same as the distribution under the present bank stock tax—namely, one-half of the proceeds to the county and one-half to the municipality in which the financial institution is located. The administration of the bank stock tax would remain as at present—namely, in the county boards of taxation and the county treasurer.

The *Commission* accordingly recommends:

VIII. That the Proposed Tax be Assessed and Collected in the Same Manner as the Present Corporation Business Tax, and that the Proceeds be Distributed in the Same Manner as the Bank Stock Tax.

PART II

Tax Lien Foreclosure

The *Commission* has deemed the subject of local property tax administration one of its major responsibilities. In this field, it has already been noted that the taxation of tangible personal property, the improvement of real estate tax administration and the development of equalization procedures are important matters for future attention. The matter of tax lien foreclosure has been selected for immediate attention for two reasons: the basic investigations have long been completed by others, and it is a subject on which public and private agencies are agreed upon as in need of remedial legislation. For example:

> STATE TAXPAYERS' ASSOCIATION:—"The excessive cost of foreclosing tax delinquent property under present law imposes a serious problem upon municipalities which would like to rid themselves of burdensome dead-wood realty, especially unimproved vacant land or lots whose market value does not justify the municipality instituting costly foreclosure proceedings for their sale. Remedial legislation should be enacted simplifying the procedure and reducing the high cost of these sales as a matter of enlightened public policy in the vital interest of the municipality and its taxpayers. Such remedial legislation should also embrace a class of tax delinquent property, in many cases unimproved vacant land or lots, whose present owners are unknown or cannot be located by local taxing authorities after efforts to do so have been made over a period of successive years; and such legislation should validate the sales of such property by the municipality and thereby provide a good, legal and marketable title to the property sold so as to be acceptable to examining attorneys, loaning authorities and any other buyers. Unproductive tax delinquent property and its disposal constitutes an outstanding municipal problem which calls for prompt legislative relief." [1]
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> * * *
>
> WALTER R. DARBY, *Director of the Division of Local Government*:—"When real estate taxes are unpaid, the collector is charged with the duty of selling the same for non-payment and if there is no outside purchaser, the property is struck off to the municipality and the tax

[1] *About the New Jersey Taxpayers Association,* pp. 13-14.

title lien is vested in the municipality. At any time after two years from the date of the tax sale the municipality may, in accordance with law, foreclose the right of redemption through the Court of Chancery and when such right to redeem is foreclosed, the municipality acquires title in fee. This property then becomes municipal property subject to sale by the municipality. The property is withdrawn from the ratables when foreclosed and is not restored thereto until sold.

"The growth of the foreclosed property asset indicates that the disposition thereof is one of the important problems of the municipalities. The asset figure represents the taxes accrued and has no reference to actual values or assessed values. In some instances, municipalities are able to dispose of foreclosed properties at a profit and in other instances at a loss. Attention is directed to the continued growth of this asset and to the fact that it is one of our major municipal problems." [2]

It is particularly timely this year to handle the matter of tax lien foreclosures. There are several reasons for this:

1) During the high earnings and cheap money period of wartime, every piece of tax delinquent property that could possibly be handled through existing machinery may be presumed to have been restored to productive use.

2) Reference to the Report of the Division of Local Government for 1944 shows that while cash tax collections reached 90.98 per cent in the year of levy, there still remained outstanding accumulated tax title liens in possession of municipalities aggregating roundly $70,000,000. This is 27 per cent of the total property taxes levied for all purposes ($256,371,015) in 1944.

3) The high level of public and private economic activity which appears certain to develop in the years ahead makes it particularly desirable to facilitate the restoration of tax delinquent lands to their most suitable economic use, either public or private.

4) As tax revenues become more affected by the restoration of normal economic conditions, it becomes more unjust to permit county and State property taxes to be apportioned to municipalities upon the basis of tax delinquent "ratables." So long as the liens remain unforeclosed and the municipality does not take title to the property, it is deemed a tax ratable and in effect it creates a continuing liability which other taxpayers have to meet.

Unimproved vacant land is the only type of property for which existing tax lien foreclosure machinery is entirely unsuited. The principal difficulty under existing law is the cost of foreclosure.[3]

[2] New Jersey State Department of Taxation and Finance, Division of Local Government, *Report* (1944), p. xii.

[3] As to the nature and scope of the entire problem, see A. M. Hillhouse and Carl H. Chatters, *Tax-Reverted Properties in Urban Areas* (Public Admin. Service: Chicago, 1942).

Foreclosure in Chancery, the only direct present method of foreclosure which will give a marketable title[4] has been estimated by the New Jersey State Planning Board to cost from $200 to $400 per parcel.[5] This cost may have been reduced somewhat by subsequent legislation, but it is still too high for use in connection with vacant land which may be worth, in some cases, as little as $10 per acre.

New Jersey has not been entirely neglectful of this problem. Two principal types of remedies have been developed: One of these types includes various devices intended to avoid the accumulation of tax liens, such as provision for installment payment of taxes, for the acceptance of a deed to the property in settlement of taxes due thereon, and, in the case of income producing property, provision for tax receivership.

The cost of foreclosure by a suit in Chancery, as in the foreclosure of a mortgage, has also been reduced by the Hess Law (*Laws of* 1940, ch. 84). This law permits a blanket foreclosure suit covering numerous pieces of property, usually in a single subdivision. Other provisions of the law are also directed toward reducing excessive costs. By contracting with a title company for a search covering all the delinquent properties (usually deriving title from one large holding) municipalities have been able to reduce the cost of this work.

But the principal elements of cost still remain. Under existing foreclosure procedure, all interested parties must be named as defendants. This means an exhaustive and costly title search, and almost prohibitive service and notice costs. In addition, there are substantial costs of references and publications.

The only way in which foreclosure costs can be reduced sufficiently to be practical in cases of property of low value, particularly vacant land, is through the procedure known as foreclosure *in rem*. This procedure has been adopted in New York, North Carolina, Minnesota, Nebraska, and in several other States and in the Model Real Property Tax Collection Law of the National Municipal League.

Before considering the details of an *in rem* foreclosure law, it is striking to note the manner in which it meets the needs for liquidation of low value tax title liens. Hillhouse and Chatters[6] report

[4] Howard W. Roberts, "Tax Lien Marketability and Eligibility for Mortgage Loans," *New Jersey Municipalities*, October, 1939, p. 12.

[5] New Jersey State Planning Board, *Premature Land Subdivision a Luxury* (1941), p. 37.

[6] *Op. cit.*, p. 30.

the following comparison of minimum costs in New York under the old *in personam* procedure with the newer *in rem* procedure, as follows:

TABLE 6

COMPARATIVE COSTS OF TWO TYPES OF MORTGAGE OR TAX FORECLOSURE PROCEEDINGS

Procedure	*Mortgage Foreclosure Plan*	*In Rem Plan*
Title search	$12.50	$00.00
Notice to redeem	5.00	0.25
Tax search	1.00	1.00
Continuation title search	3.50	0.00
Continuation tax search	1.00	0.00
Serving summons and complaint	5.00	0.25
Advertising fee	28.00	0.10
Legal fees	45.00	3.00
Total	$101.00	$4.60

Later information shows the maximum cost per *in rem* procedure in New York at $3.50, and the greater the number of parcels foreclosed, the less the individual cost per parcel, sometimes as low as 65 cents per parcel under the New York law.

Hillhouse and Chatters summarize the manner in which these results are achieved as follows:[7]

> "The most important simplified foreclosure procedure that has been developed, however, is a proceeding *in rem*, as distinguished from the ordinary foreclosure procedings *in personam*. This new procedure is especially adapted to properties of small value, and also to foreclosures where the owners are unknown, nonresident, or minors. It eliminates the necessity of title searches, personal service, referee's fees and large advertising costs. Because persons having an interest in the property need not be named in the published summons, a costly title search to ascertain their identity is unnecessary.
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> "Service is by publication pursuant to court order, for example, once a week for six successive weeks in the two or more newspapers designated in the order as being those most likely to reach all interested parties. Notice may also be posted on the property and in a prescribed public place. The burdensome and expensive process of naming each defendant in the summons and other legal papers is avoided. Defendants are described by a phrase like 'the person or persons having or claiming to have an interest in the parcel or parcels of real property described in the notice annexed hereto.' This notice contains an ac-

[7] *Ibid.*, pp. 26-27.

curate and intelligible description of the real property involved. A notice of *lis pendens* must be filed.

"Since an action *in rem* is against the land as distinguished from the owner of the land, the judgment is against the land itself and is conclusive against the world. A major defect of foreclosure *in personam* is that judgment is not binding upon persons not served with process. This often results in an unmarketable title. Proceedings *in rem* thus eliminate the principal sources of expense and delay in foreclosure suits.

"The United States Supreme Court in two leading cases has ruled that *in rem* proceedings against land constitute due process of law. In *Winona and St. Peter Land Company* vs. *Minnesota,* 159 U. S. 526 (1895), 40 L. Ed. 247, 16 S. Ct. 83, a Minnesota *in rem* tax collection statute was upheld. Again, in *Lehigh* vs. *Green,* 193 U. S. 79 (1904), 48 L. Ed. 623, 23 S. Ct. 390, the court sustained a similar Nebraska statute which permitted, when the owner of the land was unknown, a tax foreclosure proceeding *in rem.* The action was against the land itself with a provision for service by publication. The statute specifically provided that in cases where the land itself was made defendant, the deed would be an absolute bar against all persons, unless the court proceedings were void for want of jurisdiction." [8]

There are now two ways to perfect a tax title in this State, either by notice or by bill in chancery to bar the equity of redemption. Each of these procedures are available to any purchaser at a tax sale, including the municipality or a private purchaser, and each may be employed only after a tax sale. In either case, the tax sale law allows a minimum of two years from the date of sale during which there is an absolute right to redeem (*R. S.* 54:5–77 and *R. S.* 54:5–86).

The procedure by notice to redeem appears to entail the costs of a title search to determine "all persons interested in the land" (*R. S.* 54:5–77) and is ineffective against infants and mental incompetents "so long as such impediment shall continue" (*R. S.* 54:5–84). Lack of judicial supervision of the procedure also may cast some doubt on its validity to establish a good title. Except for these disadvantages the procedure by notice to redeem offers a fairly inexpensive method for municipalities to remove some delinquent properties from the tax rolls. It has been used only infrequently, however, probably because of the disfavor with which members of the bar would view titles acquired by lapse of

[8] The New York Court of Appeals has also upheld the new law in that State. *City of Utica v. Cornelia Proite,* 288 N. Y. 477, 41 N. E. (2d) 174 (1942).

time—in this case, lapse of six months from the date of service of notice.

The procedure by a bill in equity to bar the right of redemption has always been viewed as a "strict foreclosure," that is, it is unlike a mortgage foreclosure under which there is a sale of the property and distribution of the proceeds in accordance with the various interests as they appear. The strict foreclosure, following a tax sale of the property, does not contemplate a further sale but only "foreclosure" of the equity of redemption by decree of the court of chancery.[9] It is thus clear that title arises not from the decree in equity but from the tax sale itself.

The procedure by action *in rem* is designed to overcome the disadvantages of the notice to redeem, on one hand, and the excessive costs of the bill in equity on the other. Under the tax sale law, an annual all-inclusive tax sale, excepting only such tax liens as are specifically authorized by law, is mandatory. While no penalty is attached for failure to hold a tax sale, state administrative supervision of local budgets and finance has given rise, in New Jersey, to the regular exercise of the discretionary powers of such supervision to compel the holding of tax sales. The State Division of Local Government has thus implemented the mandatory tax sale requirement by withholding or conditioning its approval of local financial action, where permitted by law, so as to compel local officials to hold required tax sales. In this respect New Jersey differs from our neighboring State of New York, in which it appears to have been necessary to provide for application of the *in rem* procedure "notwithstanding any omission to hold a tax sale prior to such foreclosure."[10] It does not appear necessary in this State to depart from the strict foreclosure concept underlying existing legislation for a bill in equity.

The action *in rem* is characterized by service by publication upon all persons other than the owner of record and such other interested parties as may have specially recorded their desire to be notified by mail, and the description of persons so served by publication with such a phrase as:

> "the person or persons having or claiming to have an interest in the parcel or parcels of real property described in the notice annexed hereto."

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[9] *Mitsch v. Owens,* 82 N. J. Eq. 404 (1913); *City of Garfield v. Teier,* 135 N. J. Eq. 44, 37 Atl. (2d) 201.

[10] Tax Law Art. 7-A (as added by N. Y. Laws, 1939, Ch. 692) Sec. 165, Cahill Consol. L. of N. Y., Supp. 1939, Tax Law, Sec. 165.

This procedure, which has the full sanction of due process of law as determined by the United States Supreme Court and leading State courts also has ample analogy in existing New Jersey practice. For example, in a bill in equity to bar the right of redemption, provision is made for service by publication and foreclosure of "unknown owners." (*R. S.* 54:5–88.) Of more general application, is the similar theory in commencement of an action against a non-resident by writ of attachment. (*R. S.* 2:42–72.)

The principle here, applicable alike to all persons, including minors and mental incompetents, is that the sovereignty of the State confers power and responsibility to satisfy lawful claims for the support of government which are a charge upon property located within, and enjoying the protection of, the State. While rare cases of individual hardship might conceivably arise through divestiture of property interest by an action *in rem,* this is outweighed by the general public interest and the interest of other paying taxpayers in the liquidation of delinquent taxes and the clearance of the tax rolls of "dead wood." The allowance of a reasonable time to act, at least four years under the *Commission's* proposal, is deemed more than adequate protection of any individual interests in vacant land.

There are certain additional characteristics of the procedure which the *Commission* would emphasize:

1) The *in rem* procedure may be used only by the taxing districts themselves and not by private holders of tax liens.

2) It shall apply only to unimproved vacant land.

3) It may not be invoked until the municipality holds a tax title lien for at least four years—this is to assure that the property is not restorable to productive uses through normal market facilities.

4) Any person having an interest in real property may, by filing appropriate demand with the tax collector, require that notice of any such proceeding be mailed to him (But failure of any such person to receive the notice shall not invalidate the proceeding).

5) In accordance with the principles laid down by the United States Supreme Court, notice shall be given of the filing of the list, by posting and publication over a period of six weeks and every person, including a taxing district other than the one foreclosing, having any right or interest in or lien upon any parcel described in such list may redeem the parcel or may serve and duly file an answer, setting forth the nature and amount and any defense or objection to the foreclosure of the lien, so that every person interested has an opportunity to appear in court.

6) Any defendant who answers shall have an absolute right to the severance of the action as to any parcel, upon written demand filed with or made a part of his answer. The court shall summarily hear the issues raised by the complaint and answer and in a proper case, direct a judicial sale. The action thus proceeds to final judgment and decree and to conveyance of the land or distribution of proceeds of sale.

7) The lack of personal service shall not invalidate the proceeding, which as an action *in rem* shall follow the requirements for such actions in other cases as laid down by the United States Supreme Court.[9]

The *Commission* accordingly recommends, subject to these requirements:

IX. That An In Rem Tax Lien Foreclosure Law be Enacted for the Use of Taxing Districts in the Liquidation of Liens on Unimproved Property which is Tax Delinquent for at least Four Years after a Tax Sale.

The marketability of titles acquired by *in rem* foreclosure will, of course, depend in part upon the attitude of title insurance companies. The results of a survey for this purpose are reported as follows:[1]

"Fortunately title companies are more willing to guarantee or insure tax titles than in previous years. They usually require a foreclosure proceeding, an action to quiet title, or some other conclusive judicial action. In 1939, Howard W. Roberts, an attorney (of Snyder, Roberts and Pillsbury), Atlantic Highlands, New Jersey, made a survey of title companies in New Jersey, New York, Connecticut, Maryland, the District of Columbia, Pennsylvania, and Ohio to ascertain their attitudes and practices. Letters raising specific questions were addressed to 77 companies, 66 of whom replied. Thirty-three companies indicated their willingness to insure titles acquired by the tax lien foreclosure method. In each of these states except Pennsylvania, some leading title companies were willing to take this business. There is no provision in Pennsylvania for a tax foreclosure. Three companies would insure, under certain conditions, tax titles acquired by a summary process. There are Pennsylvania statutes curative of tax title defects (a suit in ejectment and a rule upon the apparent owners to show cause why they should not bring a suit in ejectment), but apparently they are seldom used. The proceedings are too lengthy and expensive. One company wrote: 'The tax titles that are insurable are so few that we

[9] See *Pennoyer v. Neff*, 95 U. S. 714, 24 L. Ed. 565 (1877).

[1] Hillhouse and Chatters, *op. cit.*, pp. 43-45.

always attempt to discourage an applicant for title insurance.' In the District of Columbia, it is the practice to insure a tax title only when adverse possession under color of title against the record owner has continued for 22 years. In Ohio, titles acquired by foreclosure are insurable, but none of the companies was interested in titles acquired through a tax forfeiture.

. . .

"The whole attitude of the title companies and of the legal profession toward tax titles seems to be changing. In fact, a number of lawyers in New Jersey now feel that a tax foreclosure is better than a mortgage foreclosure. In a mortgage foreclosure where the mortgage has been foreclosed and the property sold at a sheriff's sale, the sheriff's deed is the title. The mortgage and the final decree in the foreclosure merge. If there is any defect in a foreclosure, or if any party is not made a defendant, then the title is defective and there is no way of clearing up the defect. However, in the case of a tax foreclosure, the final decree is not the title; rather the original certificate of tax sale constitutes the title.

"Foreclosure of the tax title lien is merely the proceeding to foreclose the right of redemption. If for any reason all the parties in interest were not made defendants, a new action to foreclose against any party that was left out can be instituted. In other words, in a mortgage foreclosure action, if one hundred people have interests and the suit makes ninety-seven of them defendants when the sheriff's deed is issued, there is no way of cutting off the other three. In the case of a tax foreclosure, given the same error, a new action can easily be instituted to bar the three omitted defendants."

In the event that the title companies are found unwilling to insure titles acquired by municipalities through *in rem* foreclosure, the *Commission* recommends:

X. That Municipalities be Given Specific Authority to Furnish Warranty Deeds—as is Now the Practice of a Number of Local Governments.

* * *

The only remaining problem related to tax lien foreclosure arises out of the need to control the disposition of foreclosed property so as to prevent, if possible, its return to tax delinquent status. There are several procedures for this purpose now in use in other states; in each, it is necessary to classify foreclosed

property for its best economic use—private or public. Following such classification, the municipality may secure compliance through restrictive covenants and other available devices common in real estate transactions. These are matters which may not require legislation and may, in any event, await the enactment of an *in rem* foreclosure statute.

APPENDIX A

STATE OF NEW JERSEY

DEPARTMENT OF LAW

TRENTON

WALTER D. VAN RIPER
Attorney-General

December 6, 1945.

John F. Sly,
Chairman, N. J. Commission on State Tax Policy,
20 Nassau St.,
Princeton, N. J.

DEAR DOCTOR SLY:

In your inquiry of November 17, submitted on behalf of the Commission on State Tax Policy, you requested my opinion respecting the application within this State of R. S. 5219 (b) (12 U. S. C. A. 548) which statute reads as follows:

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

The questions you ask are as follows:

(1) What specific types of business would be held to come within the meaning of the phrase "coming into competition with the business of national banks"?

(2) Does the phrase "other moneyed capital in the hands of individual citizens" require that a comparable tax be assessed to the individual shareholders in a competing business, or may the requirements of the Federal statute be met by a tax measured by the value of capital stock and assessed to the competing corporation directly?

(3) If the requirements of *R. S.* 5219 (b) could be met by a tax assessed directly to the competing business entity, would it be either required or permissible to measure such tax only by the portion of a competing corporation's capital which is employed in New Jersey in competition with national banks?

(4) If the requirements of the Federal statute were to be met by a tax assessed to individual residents, according to their holdings of stocks in corporations competing with national banks, or according to their interest in unincorporated business competing with national banks, would Federal law or our State Constitution require the inclusion of shares of stock in corporations which do not compete with national banks in New Jersey but do compete with the business of national banks elsewhere?

Answering question "(1)" above, as I understand the position of the Court from the pertinent cases, the phrase "other moneyed capital" in R. S. 5219 (b) embraces moneyed capital employed in such a way as to bring it into substantial competition with the business of national banks, and that the determination of this question in every case is one of fact. Within such competition I find the following referred to in 59 A. L. R. 1 at 25: The business of commercial banking, investments in the shares of State banks, trust companies, and in private banks, and any investment business substantially identical with the business carried on by national banks. *First National Bank* vs. *Hartford,* 273 U. S. 548 (1927). *Public National Bank* vs. *Keating,* 47 Fed. 2d 561.

In *First National Bank* vs. *Hartford, supra,* and in *First National Bank* vs. *Anderson,* 269 U. S. 341, and *Merchant National Bank* vs. *Richmond,* 256 U. S. 365, the substantial holdings are that moneyed capital employed in the loan and investment business, in the making of investments by way of loans, discounts, and otherwise in notes, bonds, or other securities with a view to sale or repayment and reinvestment is in substantial competition with the business of national banks.

In *State of Minnesota* vs. *First National Bank,* 273 U. S. 561 (1927), the opinion shows that under the Minnesota statutes shares of national banks and the moneyed capital of banks or mortgage loan companies were assessed and taxed at 40 per cent of their full value in the district where located. Money and credits were taxed at the rate of three mills on the dollar of their full cash value and were exempt from all other taxation. Mortgages upon real estate and executory contract for the sale of real estate were separately taxed at a lower rate. The opinion points out that the bank share tax must be compared with the tax assessed on competing moneyed capital of individuals invested in credits, or the tax on capital invested by individuals in the shares of corporations whose business competes with that of national banks, and thus compared, there was tax discrimination within Section 5219, if moneyed capital in the hands of individuals in Minnesota is employed in sub-

stantial competition with national banks within the State. In reaching a determination that discrimination existed, the Court considered as natonal bank competition, the business of note brokers, promissory notes in the hands of individuals, and individuals and corporations, using substantial capital, engaged in business as investment houses dealing in bonds and mortgages.

In answer to your inquiry "(2)", I am of the opinion that the requirements of the Federal statute may be met by a tax assessed to the competing corporation directly, *Amoskeag Savings Bank* vs. *Purdy,* 231 U. S. 373; *State of Minnesota* vs. *First National Bank,* 273 U. S. 561; *Montana National Bank* vs. *Yellowstone County,* 276 U. S. 499; *Iowa, Des Moines National Bank* vs. *Bennett,* 284 U. S. 239; *Commissioner, etc.* vs. *Woburn,* 53 N. E. 2d 554 at 558.

I answer question "(3)" by stating it is my opinion that it is legally permissible to measure the tax on the competing business entity in the manner suggested by you.

I base this reply on the understanding that a part of the moneyed capital of said competing corporation is employed outside of New Jersey, and therefore is not, in fact, in competition with the moneyed capital of the national banks whose shareholders are taxed in this State.

In answer to your inquiry "(4)", I do not understand there is anything in the Federal law requiring that the suggested taxing act provide for the taxation of shares of stock in corporations which do not compete with national banks located in New Jersey, but do compete with national banks located outside New Jersey.

With respect to the application of our Constitution specifically, Article IV, Section VII, Paragraph 12 thereof, to such a situation, it appears that a classification of taxable subjects, which would include the two classes named by you, but which would exclude shares of stock in corporations which do not compete with national banks in New Jersey, but do compete with national banks outside of New Jersey, would have to be justified, if subject to attack as violative of Article IV, Section VII, Paragraph 12, on the ground that the consent in the Act of Congress (R. S. 5219) (b), if availed of by the State, requires such a classification as I understand was held to be the case of our Supreme Court in *Commercial Trust Company* vs. *Hudson County Board of Taxation,* 86 N. J. L. 424, and apparently affirmed by our Court of Errors in the same case, 87 N. J. L. 179. However, it cannot be overlooked that this ground for sustaining the classification may not now be available in view of the fact that the Congress has by amendment of Section 5219 provided additional methods of taxing national banks and given to the States a freer hand respecting said taxation than that which prevailed at the time of the Commercial Trust Company decision.

Very truly yours,

WALTER D. VAN RIPER,
Attorney-General.