STATE TAXATION OF NATIONAL BANK SHARES

By Henry Rottschaefert

STATE taxation of national bank shares is essentially a problem in construing section 5219 of the Revised Statutes. That section provides that nothing in the National Bank Act shall prevent the inclusion of such shares in the personal property of their owners for assessing taxes imposed by authority of the state in which the bank is located. It also grants each state permission to determine the manner and place of taxing the shares of all such banks located within it. This permission is, however, subjected to two restrictions: one relating to the manner of taxation; the other, to the place. No state may tax such shares at a greater rate than is assessed upon other moneyed capital in the hands of its individual citizens; and the shares of these banks in one state, owned by non-residents, can be taxed only in the city or town in which the bank is located. It is the former restriction that has been chiefly involved in the long line of decisions defining the limits of a state's power to tax national bank shares. Those decisions constitute the principal subject for the discussion that follows.

Revised Statutes 5219 does not require that national bank shares be taxed on an equality with other moneyed capital owned by citizens of the taxing state; it prohibits their taxation at a greater rate than applicable to such moneyed capital. Equality is therefore the minimum requirement. States have not ordinarily preferred such shares in their taxing systems; they have aimed to comply with the minimum demands only. Hence, the

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legal problem has usually been to determine whether equality had been achieved. Two distinct problems have arisen: first, what is comprehended within the term "other moneyed capital in the hands of individual citizens;" and second, what constitutes equality of rate.

**Other Moneyed Capital in Hands of Individual Citizens**

The definition of this phrase has been treated largely as a problem of defining "other moneyed capital." The qualifying language "in the hands of individual citizens" has received no extended discussion; it has seldom been mentioned except incidentally. It seems to have been assumed that the scope of the whole expression could be determined by considering its most important element. No very serious consequences, except an occasional confusion in reasoning, has resulted therefrom. Convenience of treatment will be furthered by adopting the same approach.

Congress limited the states’ power to tax national bank shares in order to protect such banks from an unequal and unfriendly competition by institutions or individuals carrying on a similar business. This purpose furnishes the key to the construction of R. S. 5219, including the interpretation of the phrase "other moneyed capital." The effect of tax systems on the distribution of capital among competing uses has always been recognized by both legislators and investors. The former have utilized the principle in protective tariff enactments to divert capital to industries into which it would not normally have gone; the large scale investment in tax exempt securities in these days of high sur-taxes sufficiently proves that the latter have not been unaware of the relation. In a broad sense every use of capital competes with its every other possible use. This is especially true of free capital, that is, capital which has not yet been definitely devoted to any specific use. An investor with a given amount of capital for investment would undoubtedly be governed in making his choice between subscribing to the shares of a national bank and those of a moving picture house by the relative tax burden on these two forms of property. But in the ordinary course of events other motives enter to determine his selection; for instance, ownership

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of the bank shares may carry with it a respectability that was at one time associated with the ownership of New Haven stock in New England. The tax factor becomes infinitely more important when, having decided to invest his capital in the business of banking, the question is whether to employ it through the instrumentality of a state bank, a national bank, or a private banking establishment. In view of these considerations and the judicially expressed purpose of R. S. 5219, the problem of defining "other moneyed capital" is ultimately that of selecting those competing uses for capital which are sufficiently similar so that the relative tax burden constitutes an important factor in a choice between them.

One of the earliest cases in which the court passed on the question was that of *People ex rel. Duer v. Commissioners of Taxes.* The New York law taxed national bank shares at their value determined, as permitted by the *Bank Tax Cases,* without deduction of the value of exempt securities held by the bank. The shares of insurance companies were not taxed to their owners, but the companies themselves were assessed on their capital computed by deducting exempt securities. If capital invested in insurance company stocks were "other moneyed capital" within R. S. 5219, the scheme of taxation would have been invalid. The court, however, held that capital so invested did not constitute such "other moneyed capital." This position was later reaffirmed. Neither of these cases gave any clue to the test to be applied in determining the question. The matter received its first comprehensive discussion in *Mercantile National Bank of New York v. Mayor, etc., of New York.* The court, after reviewing the earlier cases, stated that moneyed capital in the hands of individual citizens did not necessarily embrace shares of stock held by them in all corporations whose capital was employed in business carried on for the pecuniary profit of the shareholders; but that the shares in some corporations, according to the nature of their business, might be such capital. The test of whether shares of a given corporation were moneyed capital, as distinguished from other capital, was said to be, not the character of the investments in

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3(1866) 4 Wall. (U.S.) 244, 18 L. Ed. 344.
4(1865) 3 Wall. (U.S.) 573, 18 L. Ed. 229.
5(1865) 3 Wall. (U.S.) 573, 18 L. Ed. 229.
7(1886) 121 U.S. 138, 30 L. Ed. 895, 7 S.C.R. 826.
which, either by law or in fact, the bulk of the capital and surplus of the corporation were from time to time invested, but the nature of the business in which the corporation was engaged. If the enterprise were one in which the capital employed was money with the object of making profits by its use as money, a share or interest in such enterprise would be moneyed capital. The court stated that such moneyed capital would be included within the terms of R. S. 5219. In the course of its opinion, however, it was compelled to limit its definition by applying a further test. The case involved the New York tax system which exempted deposits in savings banks. The argument had been advanced that this effected a prohibited discrimination. The court admitted that "these deposits constitute moneyed capital in the hands of the individuals within the terms of any definition which can be given to that phrase;" but nevertheless held that they were not moneyed capital within R. S. 5219 because savings banks did not compete with national banks, which were commercial banks. The test of such competition has been repeatedly used to determine the content of the phrase "other moneyed capital." The terms of R. S. 5219, therefore, prohibit states from discriminating in their taxing systems against national bank shares in favor of capital employed in the conduct of those operations that constitute the principal activities of national banks. They do not prevent extending tax favors to capital engaged in non-competing businesses, even though its effect may be to retard the flow of free capital into the national banking field, or to increase the motives for withdrawing therefrom capital already invested therein.

The general rule just stated has received some measure of specific content in the course of a long series of judicial decisions. To determine whether a given employment of capital is a competing use requires a comparison of the business operations of national banks with those of the other businesses involved. "The business of banking, as defined by law and custom, consists in the issue of notes payable on demand, intended to circulate as money where the banks are banks of issue; in receiving deposits payable on demand; in discounting commercial paper;
making loans of money on collateral security; buying and selling bills of exchange; negotiating loans, and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations. These are the operations in which the capital invested in national banks is employed."

Capital invested in mining companies is clearly not embarked upon an enterprise competing with national banks, and hence it is not illegal to exempt their shares from taxation. The same is true of investments in telephone, wharf, or gas companies. It has also been held that investments in building and loan associations are not such moneyed capital. The shareholders’ interest in railroad and manufacturing corporations was held not to constitute “other moneyed capital,” even though it might appear that a large part of their assets were invested in “securities payable in money,” thus making them “owners of moneyed capital.”

That same case took a similar view as to shares in insurance companies, although the court admitted that the investments made by such companies might well be termed moneyed capital. It is clear that the court in so characterizing the investments made by such companies meant no more than “securities payable in money.” This, however, is an inadequate test with no particular bearing on the meaning of the term as used in R. S. 5219. It is not the particular form of the assets that is decisive of whether they constitute “other moneyed capital,” but the character of the business transactions out of which they arise. It is not overlooked that this may, and usually will, affect their form in some respects, but that is merely incidental. In the cases which the court had in mind, the transactions, in connection with which said corporations acquired the “securities payable in money,”

were not such as constituted operations of commercial banking. That alone would justify the exclusion of investments in such companies from the category of "other moneyed capital" within R. S. 5219. The court, after needless confusion, did in that very case ultimately reach the conception that the "other moneyed" capital referred to was that competing with national bank capital in "carrying on the exchanges of commerce." It was because the business of savings banks differed from, and did not compete with, that of commercial banking institutions, that savings bank deposits were not considered "other moneyed capital" within R. S. 5219. Such deposits are in substance capital borrowed by the bank from the depositors, and reinvested by it in making loans. From the point of view of the depositor they constitute investments payable in, and readily convertible into, money. The deposits are as much employed in the business of the savings bank as any other form of capital contribution. But, as said in another case, savings banks are not "banking institutions in the commercial sense of that phrase." The case of these deposits, therefore, shows that the decisive factor is the kind of transactions in which the capital is employed, not the accidental characteristic that the investor's interest is in the form of a security or credit payable in money. This is equally apparent from the fact that the exemption of investments in state and municipal bonds is not violative of R. S. 5219. These are certainly "securities payable in money." Furthermore, the definition of banking heretofore given included dealings in such securities among banking operations. The seeming inconsistency of permitting their exemption in the light of that definition is readily explained on the theory that the crucial test is competition with the more distinctively commercial operations of national banks, that is, those intimately connected with facilitating "the exchanges of commerce."

The case of trust companies has caused the court considerable difficulty. The New York tax system that was involved in *Mercantile National Bank of New York v. Mayor, etc., of New York* taxed national bank shares on an ad valorem basis, while

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trust companies were taxed on their capital and also required to pay a franchise tax based on income. This difference in method was alleged to constitute a discrimination against national bank shares. This contention was not sustained. The court's reasoning, however, leaves a doubt as to whether the basis for the decision was that capital invested in trust companies was not moneyed capital within R. S. 5219, or that the difference in method of taxation did not discriminate against national bank shares. After describing the usual and distinctive functions of trust companies, it said that:

"It is evident from this enumeration of powers, that trust companies are not banks in the commercial sense of that word, and do not perform the functions of banks in carrying on the exchanges of commerce."24

Later on in the same paragraph it stated that such companies do "receive money on deposit . . . and invest it in loans, and so deal, therefore, in money and securities for money in such a way as properly to bring the shares of stock held by individuals therein within the definition of moneyed capital in the hands of individuals, as used in the act of Congress." This was followed by the statement that the taxation of trust companies was at least equal to that upon national bank shares. In a case, decided the year after that last referred to, it was held that the interest of individuals in trust companies was not moneyed capital for the reason that "the investments made by the institutions themselves . . . are not moneyed capital in the hands of the individual citizens of the state."25 The New York tax system passed on in the Mercantile National Bank Case was again before the court in Jenkins v. Neff.26 There had been no change in the taxation of national bank shares and trust companies, but the charge of discrimination was based on the contention that the latter were in fact doing a banking business. The essence of that claim was that investments in trust companies constituted "other moneyed capital" within R. S. 5219. A state's tax system can be proved consonant with that section by showing that the capital alleged to be favored either is not "other moneyed capital" or that it is taxed at least as heavily as national bank shares. Had the court construed its own decision in the Mercantile National Bank Case as based on the

theory that investments in trust companies did constitute "other moneyed capital" which was taxed at least as heavily as national bank shares, the claim advanced in *Jenkins v. Neff* could have been disposed of as utterly irrelevant. In that event the fact that such companies were operating as banks would only make more positive the assumption on which the earlier decision had been based. The court would only have had to refer to the *Mercantile National Bank Case* as a judicial ruling that the New York system did not discriminate against national bank shares in favor of "moneyed capital" in the form of investments in trust companies. It, however, adopted no such short cut solution. It rejected the contention because, even admitting that trust companies were in fact doing a banking business, it would not presume that the state would show bad faith by permitting them to continue such operations. The decision was based on the theory that investments in trust companies were not competitive with national banking capital within R. S. 5219, even though such companies did temporarily compete because of their illegal acts. This is evidenced by the quotation, with approval, of that part of the opinion of the New York court of appeals in the same case, which Judge Woodward relied largely on that part of the decision in the *Mercantile National Bank Case* relating to savings bank deposits. As heretofore shown, these were held not to be "other moneyed capital" within R. S. 5219, because savings banks did not compete with national banks. Furthermore, the *Mercantile National Bank Case* was stated to have held that trust companies "were not in any proper sense of the term banking institutions." In a later case, however, trust companies were referred to as "other moneyed capital" and "competitive institutions;" but as expressly stated by the court, no question of discrimination between national bank shares and investments in trust companies was involved. This dictum, coupled with the uncertainty as to the real grounds for the decision in the *Mercantile National Bank Case*, leaves the status of investments in trust companies somewhat in doubt. It is probable that investments in trust companies with the powers exercised by those involved in *Jenkins v. Neff*, would today be considered as not within "other moneyed capital." In any given case, however, the varying powers conferred upon such companies under the laws of the different states would be an im-

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27(1900) 163 N.Y. 320, 57 N.E. 408.
important factor. That national banks are today permitted to engage in the business of trust companies under the conditions prescribed in the Federal Reserve Act,\(^2\) should not affect this conclusion. That amendment has merely authorized national banks to assume functions beyond those of ordinary commercial banking, in order to put them on a competitive equality, not with trust companies, but with state banks where the latter are permitted to combine trust company operations with the conduct of commercial banking. It has in no sense expanded the strictly banking powers of national banks.

The discussion thus far has been largely as to what is not "other moneyed capital." It remains to point out what has been held to be included therein. It has always been considered that credits and notes, held by individuals, would be included if competitive with national banking capital.\(^3\) The question was squarely raised and definitely decided in the case of Merchants National Bank v. Richmond.\(^4\) That case defined "other moneyed capital" as including "not only moneys invested in private banking, properly so-called, but investments of individuals in securities that represent money at interest and other evidences of indebtedness such as normally enter into the business of banking."\(^5\)

Not all credits owned by individuals constitute "other moneyed capital," for in several cases the court has refused relief where the tax systems favored some credits.\(^6\) The term includes only credits, notes and securities that arise in connection with transactions similar to those carried on by national banks. That capital invested in private banking institutions is "other moneyed capital" scarcely requires citation of authority.\(^7\)

Revised Statutes 5219 prohibits the taxation of national bank shares at a higher rate than that assessed on "other moneyed capita-
tal in the hands of individual citizens" of the taxing state. As has been stated, the last part of this expression has been practically neglected in the decisions. This has resulted in one complication that might have been avoided. Contrary to what would seem to be the natural meaning of this section, it is not necessary to compare the tax burden on national bank shares with that on the individual citizen's legal interest in competing moneyed capital. It is clear from the language of the section that Congress considered the shareholder's interest in the capital and surplus of national banks as moneyed capital. It is equally certain from the cases that the shareholder's interest in the capital and surplus of competitive institutions constitutes moneyed capital. In both these cases it is moneyed capital in the hands of individuals. The shareholder's interest in corporate assets is legally distinct from that of the corporation in such property. The states can levy no tax on national banks except on their real property. In the Owensboro National Bank Case the state sought to uphold a tax on the franchise and property of national banks on the theory that such a tax was in effect one on the shareholder's interest. The court, however, held that, even if such tax were in fact equivalent to one on the shareholders, the two were not equivalent in law because the shareholder's and the corporation's interest in the latter's assets were in law distinct things. The same reasoning would lead to the conclusion that a tax on the franchise or property of state banks and other institutions competing with national banks was not the legal equivalent of a tax on the shareholder's interest in such companies. From this point of view, the language of R. S. 5219 would require a comparison between the rates on national bank shares and the shares of stock in competing financial institutions, as far as "other moneyed capital in the hands of individual citizens" consists of such shares. If then a state did not tax such shares as property to their owners, although it might be taxing the corporations themselves, the system would violate the section, if national banks shares were taxed, since the rate on the other individual moneyed capital, consisting of the shares first referred to, would be nil. The court has, however, not carried its own reasoning in the Owensboro Case to its logical conclusion. It has held that a tax on national bank shares is not illegal merely because shares in state banks are not taxed to their owners when

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these banks themselves are taxed on their property. The tax on national bank shares may, therefore, be compared either with that on shares owned by citizens in competing institutions, or with that assessed against those institutions themselves. It frequently happens that national bank shares are taxed as property while competing institutions are taxed on some other basis, such as a franchise tax measured by income. There is generally little, if any, relation between the ad valorem rate and such franchise rate. To determine whether the application of these different methods gives substantial equality as between national bank shares and the shareholder’s interest in such other institutions, may frequently require highly complex computations. The same necessity would, of course, exist if national bank shares were taxed as property on an ad valorem basis while the shares of competing institutions were taxed on income. But in the former situation there is the added complication of translating a tax burden on the corporation into one on its shareholders. In practice the court seldom, if ever, performs such mathematical computations. Resting itself on the principle that substantial equality only is required, it makes a more or less accurate judgment as to the relative tax burden imposed on national bank shares and competing individual moneyed capital, without considering how the tax on competing institutions bears on their shareholders. The result is an additional complication in the sufficiently complex problem; one, too, which might have been avoided by declining to consider a tax on the companies as the legal equivalent of a tax on their shareholders, even though in its ultimate incidence the tax might be wholly borne by them through an equivalent diminution of the book value of their shares.

A state’s tax system may provide a scheme of taxation in terms discriminating against national bank shares in favor of other moneyed capital, and yet not violate R. S. 5219. Such potential favoritism is not decisive. If there is in fact no such other moneyed capital, there would be no actual taxation of national bank shares discriminating in favor of competing capital. The very idea of discrimination involves a comparison of two things; if one be absent, there can be no discrimination in fact. The failure to prove the existence of a substantial amount of competing moneyed capital in the form of individual credits was held a sufficient reason for the refusal to invalidate a state statute that allow-

ed debts to be set off against credits but not against the value of national bank shares. Had such fact been shown, the law would have been repugnant to R. S. 5219. This whole matter has been adequately expressed in First National Bank of Garnet v. Ayers in the following language:

"In order to come to a decision in favor of the plaintiff in error it would be necessary for this court to take what counsel for plaintiff call judicial notice of what is claimed to be a fact, viz., that the amount of moneyed capital in the state of Kansas from which debts may be deducted, as compared with the moneyed capital invested in shares of national banks, was so large and substantial as to amount to an illegal discrimination against national bank shareholders. This we cannot do. There is no proof whatever upon the subject. . . When proof shall be made regarding that matter, it may then be determined intelligently whether, within the case of Mercantile National Bank v. New York . . . there has been a real discrimination against the holders of national bank shares, and hence a violation of the above-cited Act of Congress.

In both Merchants National Bank v. Richmond and Hanover National Bank v. Goldfogle the existence of material amounts of competing money capital is emphasized. The mere existence of a few state banks with statutory limitations to a rate below that assessed on national bank shares does not constitute a substantial amount of competing capital, but where there were fifty-three such banks, there was held to be a discrimination in favor of a material amount of competing capital. Revised Statutes section 5219, therefore, is aimed at discrimination in favor of actually existent competing moneyed capital, and this must be proved by those who allege the invalidity of state tax laws.

What Constitutes Equality of Rate.

Revised Statutes section 5219 permits the inclusion of national bank shares in the valuation of their owner's property, and their
taxation at rates not greater than assessed on competing moneyed capital. It has never yet been decided that these provisions limit a state to taxing such shares on an ad valorem basis, although in the Hanover National Bank Case that argument was advanced by counsel for respondent. The governing principle in testing a state's tax system for consonance with the federal statute is that taxation, not merely the rate, shall be equal. This was definitely announced in People v. Weaver, although that decision was in fact based on an inequality of rate prejudicial to national bank shares. Equality, however, does not require similarity of treatment in every respect. A state can require national banks to collect at the source the tax due on its shares even where state banks are given an option in that respect. Such provisions have little, if any, effect on the tax burden. Nor is it a violation of the section to retroactively assess a penalty upon national banks for failing to report shares owned by residents, which were during such periods taxable to their owners, although state banks were not required to make any such returns. But penalties cannot be so assessed for failure to report shares owned by non-residents of the state whose interest during the period was not taxable under the state law.

The equality demanded by R. S. 5219 does not require national bank shares and competing moneyed capital to be treated exactly alike in matters connected with the administration of taxes. The actual tax burden depends upon at least two factors, the basis on which the tax is assessed, and the rate. If both national bank shares and competing moneyed capital are directly assessed on an ad valorem basis, the problem of equality of taxation is reduced to the single one of comparing rates. Such was the situation in Merchants National Bank v. Richmond. A state may, however, be taxing national bank shares on value while competing moneyed capital...
capital is taxed on income. The existence of equality can then be determined only by reducing the income rate to an equivalent rate on the value of the capital which produced the income, or by converting the ad valorem rate to an equivalent rate on the income received on the national bank shares. The difficulties of such a difference in method will be considered when discussing the Hanover National Bank Case. Another combination of methods is the direct taxation of national bank shares on their value, and an indirect taxation of the shares of competing institutions through a tax assessed against those institutions themselves. The court has passed on such situations in several cases. In Davenport National Bank v. Board of Equalization\(^51\) national bank shares were taxed in the usual manner while state savings banks were taxed on their capital, the shares of the latter not being taxed. This was sustained because discrimination was neither "a necessary nor a probable inference from anything in this system of taxation," nor shown "by any actual facts in the record." A similar contention was made in Covington v. First National Bank of Covington,\(^52\) where state banks were taxed on franchise, their shares not being taxed. As to this the court said that there was "nothing in the bill to show that this difference in method operates to discriminate against national bank shareholders." It follows, therefore, that R. S. 5219 permits direct taxation of national bank shares while the shares of competing institutions are taxed only indirectly, unless the "usual or probable effect" of such difference in method, or its actual results, is a discrimination against the former. This can be illustrated by comparing Bank Tax Cases\(^53\) with San Francisco National Bank v. Dodge.\(^54\) In both, national bank shares were directly taxed to their owners, state bank shares indirectly through a tax on the capital of the banks. States cannot tax those portions of corporate capital invested in federal bonds,\(^55\) but their value need not be deducted in valuing national bank shares.\(^56\) If the nominal rate of assessment on national bank shares and state bank capital is the same, the effective rate of the direct tax on the former will be greater than the effective rate of the indirect tax on shares of

\(^{51}\) (1887) 123 U.S. 83, 31 L. Ed. 94, 8 S.C.R. 73.
\(^{52}\) (1904) 198 U.S. 100, 49 L. Ed. 963, 25 S.C.R. 562.
\(^{53}\) (1865) 3 Wall. (U.S.) 573, 18 L. Ed. 229.
\(^{54}\) (1904) 197 U.S. 70, 49 L. Ed. 669, 25 S.C.R. 384.
\(^{56}\) Bank Tax Cases, (1865) 3 Wall. (U.S.) 573, 18 L. Ed. 229.
state banks in every case in which any part of the latter's capital is invested in exempt securities. The only way of maintaining equality of effective rates in that situation is by allowing the deduction of exempt securities owned by national banks in computing the value of their shares. This was not permitted in the *Bank Tax Cases*, but was allowed by the California laws in the *San Francisco National Bank Case*. The court accordingly held the taxes involved in the former invalid, solely for that reason, but decided that the mere difference in method did not vitiate the California law. In none of the cases referred to in this paragraph did it appear that there were any state bank shares actually favored. Apparently it is sufficient if the necessary, usual or probable effect is discriminatory; individual instances of actual favoritism to competing capital need not be shown.

The two cases last discussed involved comparisons of direct tax burdens on national bank shares with indirect burdens on shares of competing institutions, both kind of taxes being based on value. The problem would have been more complex had the competing institutions been taxed on some other basis. In that case it would have been necessary to translate an indirect tax burden on one basis into an equivalent direct one on another base. The federal Supreme Court has never yet had to face that situation squarely. The New York court, however, passed on a tax system in which national bank shares were taxed on value, and private banking capital on income, in the *Hanover National Bank Case*. New York taxed shares in national and state banking associations at one percent on their book value. The state income tax law was construed as applying to dividends on national bank shares, as well as the income from private banking and other individual moneyed capital. Such private banking and other competing moneyed capital was not subject to any ad valorem taxes, neither for state nor local purposes. As thus construed the law was clearly discriminatory against national bank shares since it taxed them on both income and value, while competing capital was assessed on income only. The argument had been made, however, that dividends on national bank shares were not subject to the income tax. The tax on national bank shares was held invalid even on this assumption. In discussing this part of its decision the court said:

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"We are forced to compare two methods which are wholly unlike. How can equality be established or presumed as the necessary result of taxing statutes? In a very considerable number of cases the valuation tax must inevitably be the heavier burden. It is fixed and certain. The income tax is variable and dependent on income and the amount of income. It is conceivable that when returns on such capital are low, the bank stock would be taxed and the competing capital would be exempt. In no event would equality exist unless the income on competing capital were large beyond the dreams of avarice and the usual returns on investments."

The court's reasoning is in general sound; there is, however, one qualifying factor which it overlooked, that is, the ad valorem rate at which national bank shares are taxed as compared with the rates levied on income. This factor would not have affected the conclusion in the instant case, for the income tax rates were relatively low. The court does not state whether the proof showed actual cases of substantial inequality in sufficient number to make the discrimination really existent. In view of the existence of material amounts of competing private banking capital, it is a practical certainty that favoritism did in fact exist. But, as in the cases heretofore discussed, the tax was held invalid because inequality was "the necessary result of the taxing statutes."

The feature of state tax systems that has been assailed as violating R. S. 5219 more frequently than any other is permitting personal debts to be deducted from personal property in general, or from credits, but not from the value of national bank shares. One of the earliest cases on this point involved the New York tax laws which allowed debts to be set off against all forms of personal property except bank shares, state and national. All personal property, including such shares, was taxed on its value at a nominally uniform rate. The deduction of such debts from those credits which were in fact competing moneyed capital was held to result in taxing such moneyed capital at a net value less than its real value, while national bank shares were assessed at full value. The same nominal rate would, under such circumstances, produce unequal effective rates discriminatory against national bank shares. The tax in question was held invalid for that very reason. The court again passed on the same features of the identical tax laws in Board of Supervisors v. Stanley, in which there were two classes of complainants, those who proved individual debts, and those who did...

58 People ex rel. Williams v. Weaver, (1879) 100 U.S. 539, 25 L. Ed. 705.
59 (1881) 105 U.S. 305, 26 L. Ed. 1044.
not. The earlier case was construed as a decision that the tax was invalid as to the complainant, not void under all circumstances. The court therefore held the tax invalid as to those who had proved just debts, valid as to the other complainants. The opinion contains the following language:

"It is very difficult to conceive why the Act of the Legislature should be held void any further than when it affects some right conferred by the Act of Congress... When a shareholder has no debts to deduct, the law provides a mode of assessment for him, which is not in conflict with the Act of Congress, and the law in that case can be held valid." 60

This, on its face, seems to require the existence of actual discrimination as a condition to declaring a tax invalid. It would be incorrect, however, to deny that the "necessary results of the taxing statutes" is still the usual test. Permitting individual debts to be deducted from credits and not from the value of national bank shares violates R. S. 5219,61 but allowing unincorporated banks to deduct business debts is valid since the debts of national banks have inevitably been considered in determining the value of their shares.62

The case of New York ex rel. Amoskeag Savings Bank v. Purdy63 should be compared with Board of Supervisors v. Stanley. The New York statute taxed national bank shares at a flat one percent rate on book value, but in no case was the rate to exceed that contemporaneously assessed on general property,64 which rate applied to private banking capital. The rate on such shares might, therefore, be less than that on private banking capital; it could never be greater. Personal debts were not deductible from the value of national bank shares, but could be set off against private banking capital. This was the gravamen of the relator's charge of discrimination. It had debts at least equal to the value of the shares owned. It seemed to be in exactly the position of those complainants in the Stanley Case as to whom the tax involved had been held invalid. Nevertheless, relief was denied. The tax system involved in the Amoskeag Savings Bank Case taxed both national bank shares and private banking capital on

63(1913) 231 U.S. 373, 58 L. Ed. 274, 34 S.C.R. 114.
64This qualification was made a part of the New York statute by the decision of the New York court of appeals in People ex rel. Bridgeport Savings Bank v. Feitner, (1908) 191 N.Y. 88, 83 N.E. 592.
value. The nominal rate was not, however, necessarily the same. Hence, permitting personal debts to be deducted from the latter but not the former would not necessarily, or even probably, result in a higher effective rate on national bank shares. Whether or not it did would depend upon the actual relation of the general property rate to that on such shares, and the extent to which private banking capital was in fact offset by the personal debts of its owners. The difference in rate might equalize or more than offset the advantage accruing to private banking capital from the deduction of such debts. The court held that the relator had the burden of proving discrimination, and that this had not been met by merely showing that it had debts which it was not permitted to deduct while private banking capital could deduct similar debts. It was because the manner of taxing the two classes of capital was different that the court refused to apply the decisions in People v. Weaver and the Stanley Case. The difference is important for the reasons just stated. Where, therefore, the necessary result of the preference to other moneyed capital in the matter of deducting debts is prejudicial to national banking capital, the burden is sustained by a mere showing that the owner of national bank shares has debts; where the necessary result is not such, that showing is insufficient. The comparison of these cases shows that, under taxing statutes like those now being discussed, the existence of debts owed by national bank shareholders is not a test to determine whether the tax system is discriminatory; that fact merely furnishes a test for limiting the class of those who can complain of a discrimination that exists. It should be noted that, just as in the case of other forms of alleged inequality, no question was raised in any of these cases as to whether there were in fact any personal debts set off against private banking capital so that the legal advantage was more than formal.

The simplest method of producing inequality, except an actual discrimination in rates, is by a systematic overvaluation of national bank shares, or undervaluation of competing moneyed capital. This might be practiced where both kinds were directly taxed, or where national bank shares were taxed directly and the shares of competing institutions taxed indirectly. It is illegal discrimination to assess national bank shares at a higher percentage of their actual value than other banking capital, even though the statute requires all property to be assessed at its real value. But such

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discrimination must be intentional and systematic, not accidental.\textsuperscript{66} In one case national bank shares were to be assessed at their full cash value, which the federal Supreme Court construed as requiring a consideration of all the bank’s intangibles. It interpreted the state law as assessing state banks on their property exclusive of such intangibles. The statute made no such exclusion, but the absence of a state decision requiring their inclusion was held equivalent to their legal exclusion. The tax on national bank shares was, therefore, held invalid.\textsuperscript{67} The decision may have been correct as applied to its facts; even that is doubtful. Its method of reasoning is clearly unwarranted. An even more curious and doubtful result was achieved in Bank of California, National Association v. Henderson.\textsuperscript{68} California taxed the shares of both state and national banks on their value, at the same uniform rate. Value was fixed at the book figure after deducting the value of the real property owned. The Bank of California owned shares in another national bank located within the state. The state tax on those shares was upheld. Its own shares were assessed at book value, as above defined, without deduction of the value of the shares owned in said other national bank. This was held to violate R. S. 5219. The court’s reasoning is most turgid. It seems to base its decision on the theory that, “from the point of view of ultimate beneficial interest,” the stockholder and the bank are one. This factor would be important only in so far as it supported a conclusion that the taxation to the bank of the shares owned by it, and the assessment of its own shares at a value that included those same shares, constituted a double tax burden on its shareholders. The court, however, explicitly stated that it would not “stop to point out the double burden resulting from the taxation of the same value twice which the assessment manifested, as to do so could add no cogency to the violation of the one power to tax by the one prescribed method conferred by the statute, and which was the sole measure of the state authority.” Under this decision shares in state banks would be taxable at their book figure less the value of the real estate owned, while in determining the value of national bank shares a further deduction would have to be made. This creates a preference in favor of national bank shares. It is

the only case in which R. S. 5219 has been construed as requiring more than equality of position as between national bank shares and competing moneyed capital. The decision is unsupportable, and in some respects directly contrary to earlier cases, as the dissenting opinion of Justice Pitney clearly shows.

The foregoing discussion has aimed to derive from judicial decisions the tests to be applied in determining the validity of state taxation on national bank shares. No state can impose on them a heavier tax burden than on competing moneyed capital. There is no illegal discrimination unless there exists in fact a substantial amount of such competing capital. In this respect the test is one of fact. Whether the state statutes discriminate against national bank shares in favor of existing competing capital depends on whether their necessary, usual, or probable result is to produce prejudicial inequality. It is not necessary to show that some existing competing money capital is in fact favored. This is clearly shown in the cases involving the deduction of personal debts from private banking capital. Such deduction would clearly not in fact produce prejudicial inequality unless (a) some private banking capital was actually offset by such debts, and (b) some national bank owners were prevented from making similar deductions from the value of their shares. If the statute is one that permits debts to be deducted from personal property in general, the above tests could be satisfied only by showing (a) that the personal property of the owner of private banking capital, other than such capital, was less than his debts (for otherwise it could be argued that the deduction had been made from such other property), and (b) that the debts of the owner of national bank shares exceeded his other personal property (for otherwise it could be argued that he had deducted all his debts from such other property and, therefore, had none left to be set off against his bank shares). The only reasonable alternative to such refinements of proof would be a legal rule that debts should be considered deductible ratably over all the property against which the law permits them to be set off. Requiring such strict proof might operate to defeat the purpose of R. S. 5219, or at least make its realization difficult. The test actually used, therefore, is adequate, and, in most cases, would be found in accord with the facts. While, therefore, discrimination can be proved by showing that the necessary result of the tax system is to produce prejudicial inequality, only they can raise the point who are actually injured.
CONSTITUTIONAL ASPECTS

Recent decisions holding state tax laws invalid because in conflict with R. S. 5219, have created a demand both for a revision of that section, and a re-examination of the entire question of Congressional authority to limit the states' power to tax national bank shares.\(^6\) It has been suggested that, apart from that section, the states would have power to tax national bank shares owned by residents or with a situs therein.\(^7\) The language of R. S. 5219 is practically the same as that found in the act of June 3, 1864,\(^7\) creating the national banking system. Congressional permission to tax has, therefore, existed as long as there have been any national bank shares to tax. It follows that there can have been no decision on the point in respect of shares of national banks organized under our present National Bank Act. Nor has any decision been found affirming or denying this power in the states as to shares in earlier banks created under the federal law. Analogical reasoning from recognized principles, and dicta, constitute our only ground. \textit{McCulloch v. Maryland} contains dicta that the principle on which it was decided would not prevent state taxation of the citizens' interest in the Bank of the United States;\(^7\) but several of the cases that have arisen under R. S. 5219 explicitly declare that the states could not tax national bank shares without Congressional permission.\(^7\) These later dicta clearly view the taxation of such shares as prohibited by the principles of \textit{McCulloch v. Maryland} and \textit{Osborne v. Bank},\(^7\) denying the states power to tax federal agencies performing federal functions. National banks are federal agencies, but the bank's and the shareholder's interest therein are separate legal things. Extending the principle exempting federal agencies from state taxation to the shareholder's interest in such bank must assume either that that interest is itself a federal instrumentality, or that the realization of the federal purposes the banks were incorporated to subserve requires such extension. Neither of these assumptions is so free from doubt as to give to these dicta the quality of a logical application of con-
stutional principles to the situation. However, the probabilities are that, were the court called upon to decide the question, the dicta of the later cases would become the rule of decision.

If the conclusion of the preceding paragraph be correct, the question arises whence Congress derives its authority to consent to such taxation. The principle of *McCulloch v. Maryland* does not rest on any express constitutional limitation on the taxing power of the states, but on implications derived from the nature of the federal system established by the constitution. The situation is not one in which the states delegated a part of their taxing power to the federal government, which Congress by R. S. 5219 re-delegated to the states. The power of Congress to do that would be more than doubtful. Nor is it a case of a concurrent power to tax such shares, the states being permitted so to do in so far as their tax laws did not conflict with Congressional action on the same subject. It is rather that, in adopting a constitution establishing a federal system, the states consented not to use their reserved powers, including the general power of taxation, so as to impair the efficient exercise of federal powers. If Congress by a valid law determines that a given federal power shall be exercised in a certain manner, the states cannot prevent it by exercising any of their reserved powers. But this implied limitation on the states exists only for the benefit of the federal government. In the first instance Congress can determine what state action shall not be deemed an impairment of efficient federal action. The decisions under R. S. 5219 frequently state that it prescribes the full measure of a state's power to tax national bank shares; the power of Congress to permit their taxation at all is assumed without argument. Since, however, the restriction is a matter of constitutional law, its exact scope is ultimately a problem in interpreting that document, that is, a judicial question. Hence it would probably be held that there is a limit to the power of Congress to grant the states permission to tax these shares. That limit will have to be determined in the light of the purposes of that constitutional restriction. As heretofore stated, its aim is to insure the realization by the federal government, or its agencies, of the purposes

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75See on the "delegation theory," People ex rel. Williams v. Weaver, (1879) 100 U.S. 539, 543, 25 L. Ed. 705.
76See on the "concurrent power theory," Bank Tax Cases, (1865) 3 Wall. (U.S.) 573, 585, 18 L. Ed. 229.
for which federal powers were granted, by prohibiting state action preventing absolutely, or impairing, the exercise of those powers. State action aimed at federal powers would normally consist in either absolute prohibition or discriminatory enactments. As long as investors in national bank shares are not discriminated against on that account, the efficient functioning of the national banks will not usually be defeated or impaired by permitting such shares to be taxed. Revised Statutes, section 5219 is framed on that very theory, and in practise operates as an adequate safeguard. Every proposal to relieve the situation of some of its complications will have to consider this factor; else they may turn out to be a wasted effort.\textsuperscript{79}

\textsuperscript{79}Since this article was written, Congress has amended R. S. 5219 in several important respects. It has substituted for the expression "other moneyed capital" the phrase "other moneyed capital employed in the business of banking."