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## National Bank Taxation in California

AS A RESULT of recent decisions of the United States Supreme Court,<sup>1</sup> California is facing a serious situation in the matter of bank taxation. The problem of taxing intangible property in the hands of individuals is so intimately related to the problem of taxing national bank shares that any policy with regard to intangibles can be carried out only after a most careful consideration of its relation to bank taxation. Furthermore, if the method of levying a tax on national banks measured by their net income, which is permitted by recent Congressional enactment and authorized by a recent amendment to the state constitution, is adopted by the legislature its relation to taxation of other financial and business corporations will also have to be considered because of the conditions attached to the authorization of this method of bank taxation, and because of its intimate connection with the subject of taxing the income of tax exempt securities. The objects of this paper are : (1) to examine the constitutional basis of state taxation of national banks; (2) to survey briefly the federal statute and decisional law on the subject; (3) to show the relation of the California law on the taxation of intangibles and bank shares to the federal law; and (4) to point out problems that must be faced by the State in complying with the present requirements of the federal government.

The complexity and wide scope of the subject render it impracticable to cover the whole field in the space available in one number of this REVIEW. It has therefore been necessary to divide this article into two parts, the second of which will appear in March. The present installment comprises a discussion of the constitutional basis of state power to tax national banks and an examination of the rules of law which have developed out of the operation of the share method of taxation, which has been in use since 1864, and until 1923, was the only method permitted.

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<sup>1</sup> Merchants National Bank v. Richmond (1921) 256 U. S. 635, 41 Sup. Ct. 619; First National Bank v. Anderson (1926) 269 U. S. 341, 46 Sup. Ct. 135; First National Bank of Hartford v. Hartford (1927) 273 U. S. 548, 47 Sup. Ct. 462; Minnesota v. First National Bank of St. Paul (1927) 273 U. S. 561, 47 Sup. Ct. 468.

## I. THE BASIS OF STATE POWER TO TAX NATIONAL BANKS

It has been assumed by most people and has been emphatically set forth in court dicta that the power of the states to tax national banks or national bank shares in the hands of individuals depends entirely upon permissive legislation of Congress. The latest dictum of the Supreme Court to this effect is found in the case of *First National Bank v. Anderson*,<sup>2</sup> where the court says:

"National banks are not merely private moneyed institutions but agencies of the United States created under its laws to promote its fiscal policies; and hence the banks, their property and their shares cannot be taxed under state authority except as Congress consents and then only in conformity with the restrictions attached to its consent."<sup>3</sup>

The court has held this view for a long time, as is evidenced by the early case of *People v. Weaver*,<sup>4</sup> in which, speaking of the share method of taxing national banks, authorized by act of Congress, Mr. Justice Miller, delivering the opinion of the court, declared:

"That the provision which we have cited [U. S. Rev. Stats. § 5219] was necessary to authorize the States to impose any tax whatever on these bank shares, is abundantly established by the cases of *McCulloch v. The State of Maryland*, 4 Wheat. 316; *Osborn v. Bank of the United States*, 9 *id.* 738; and *Weston v. The City Council of Charleston*, 2 Pet. 449."<sup>5</sup>

In practically none of the cases in which this point has been raised has the court seen fit to analyze the constitutional basis of the state's power to tax national bank shares; instead, the court has rested entirely upon the authority of earlier cases, and these all depend ultimately upon

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<sup>2</sup> 269 U. S. 341, 347, 46 Sup. Ct. 135, 138.

<sup>3</sup> In *Bank of California v. Richardson* (1919) 248 U. S. 476, 483, 39 Sup. Ct. 165, 166, Mr. Justice White, delivering the opinion of the court, and speaking of Section 5219 of U. S. Revised Statutes which authorizes state taxation of national bank shares, declared: "There is also no doubt from the section that it was intended to comprehensively control the subject with which it dealt and thus to furnish the exclusive rule governing state taxation as to the federal agencies created as provided in the section. All possibility of dispute to the contrary is foreclosed by the decisions of this court. *People v. Weaver*, 100 U. S. 539; *Mercantile Bank v. New York*, 121 U. S. 138, 154; *Owensboro National Bank v. Owensboro*, 173 U. S. 664; *Covington v. First National Bank*, 198 U. S. 100."

The bank's personal property is not subject to state taxation even after the bank has passed into the hands of a receiver, the bank still retaining its character as a federal instrumentality. *Rosenblat v. Johnson* (1881) 104 U. S. 462. The court decided the case on authority of prior cases without discussing the problem involved. A tax levied on the bank on its capital stock, surplus, and undivided profits is invalid. *National Bank v. Adams* (1922) 258 U. S. 362, 42 Sup. Ct. 323. A franchise tax by a state upon national banks has also been held invalid. *Owensboro National Bank v. Owensboro* (1899) 173 U. S. 664, 19 Sup. Ct. 537.

<sup>4</sup> (1879) 100 U. S. 539.

<sup>5</sup> 100 U. S. 539, 543.

the authority of *McCulloch v. Maryland*.<sup>6</sup> But to cite *McCulloch v. Maryland* as authority for the propositions quoted is to extend the actual decision therein to a subject not covered by the reasoning of the court and in fact expressly excluded from its operation. The case decided that a Maryland statute which imposed a tax on each bank note issued by "Banks or branches thereof in the State of Maryland not chartered by the legislature" or in lieu thereof an annual tax of \$15,000 upon any such bank or branch, was invalid as applied to the United States Bank. The privilege of issuing notes as a means of obtaining money which it might lend profitably was deemed at this time to be one of the most important features of successful banking. It was with these facts in mind that Marshall wrote and with them in mind his general expressions of opinion are to be read. The tax was not objectionable because it would come eventually out of the pockets of the real owners of the bank, as indeed any tax paid by the corporation would do, but because the tax would operate directly to restrain a function deemed important to the success of the bank. In other words, it tended to "retard, impede and control" the operations of this bank which Congress had constitutionally authorized as an aid to the fiscal transactions of the government. In the words of Marshall, "the states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government. This is, we think, the unavoidable consequence of that supremacy which the constitution has declared."<sup>7</sup> The case stands, therefore, for the proposition that the state may levy no tax whatever on the functions, or privilege of exercising the functions, with which the bank has been endowed by Congress. At the same time, however, it is to be noted that the court expressly recognized that the state could tax the property existing in the state independently of the entry of the bank, including the land belonging to the bank and the capital invested therein by the shareholders, provided these latter were not taxed discriminatorily. But the functions of the bank were created by the federal charter. Such a federal corporation and such functions had no previous existence in the state and therefore the decision that these functions were not taxable by the state did not, said the opinion, withdraw anything that had been previously within the taxing power of the states:

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<sup>6</sup> (1819) 17 U. S. (4 Wheat.) 316.

<sup>7</sup> 17 U. S. (4 Wheat.) 316, 436. The rule laid down in this quotation is still law. *Johnson v. Maryland* (1920) 254 U. S. 51, 41 Sup. Ct. 16; *Clallam County v. U. S.* (1923) 263 U. S. 341, 44 Sup. Ct. 121; *Panhandle Oil Co. v. Mississippi* (1928) 277 U. S. 218, 48 Sup. Ct. 451; *Long v. Rockwood* (1928) — U. S. —, 48 Sup. Ct. 463.

"This opinion does not deprive the states of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the state, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the state. But this is a tax on the operations of the bank, and is, consequently, a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution. Such a tax must be unconstitutional."<sup>8</sup>

This dictum seems to be a clear recognition by the court that the states had power under the Constitution without a permissive law of Congress to tax the real property of the bank and to tax national bank shares in the hands of individuals.<sup>9</sup> This part of *McCulloch v. Maryland* has apparently been overlooked or ignored in the cases quoted from above.

The precise question whether or not the states have an original right to tax national bank shares might perhaps have been presented to the Supreme Court had Congress not seen fit in 1864 to enact a law expressly recognizing, or granting, the power of the states to tax bank shares and the real property of national banks.<sup>10</sup> When the present system of national banks was established in 1863 no provision was made for state taxation of the banks or the shares therein. The following year, however, congressional consent was given to tax both the real property of national banks and national bank shares in the hands of individual citizens.<sup>11</sup> This provision was altered in 1868<sup>12</sup> (becoming

<sup>8</sup> 17 U. S. (4 Wheat.) 316, 436.

<sup>9</sup> See Alfred J. Schweppe, *State Taxation of National Bank Stocks: Uncertainty of its Constitutional Basis* (1922) 6 MINNESOTA L. REV. 219.

<sup>10</sup> Prior to 1863 a national bank existed in this country for only a total period of forty years: The United States Bank 1791-1811 and the Second United States Bank 1816-1836.

<sup>11</sup> "Provided, That nothing in this act shall be construed to prevent all the shares in any of the said associations, held by any person or body corporate, from being included in the valuation of the personal property of such person or corporation in the assessment of taxes imposed by or under state authority, at the place where such bank is located, and not elsewhere, but not at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such state: *Provided further*, That the tax so imposed under the laws of any state upon the shares of any of the associations authorized by this act shall not exceed the rate imposed upon the shares in any of the banks organized under authority of the state where such association is located: *Provided, also*, That nothing in this act shall exempt the real estate of associations from either state, county, or municipal taxes to the same extent, according to its value, as other real estate is taxed." 13 STAT. 112 (1864).

<sup>12</sup> Section 5219 of the Revised Statutes, as adopted in 1868 and in force for approximately fifty-five years, read as follows: "Nothing herein shall prevent all the shares in any association from being included in the valuation of the personal property of the owner or holder of such shares, in assessing taxes imposed by authority of the State within which the association is located; but the legislature of each State may determine and direct the manner and place of taxing all the

Section 5219 of the Revised Statutes), and remained as thus altered until 1923,<sup>13</sup> when it was again amended. It was further amended in 1926.<sup>14</sup> Under this latest amendment the states are authorized, subject

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shares of national banking associations located within the State, subject only to the two restrictions, that the taxation shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State, and that the shares of any national banking association owned by non-residents of any State shall be taxed in the city or town where the bank is located, and not elsewhere. Nothing herein shall be construed to exempt the real property of associations from either State, county or municipal taxes, to the same extent, according to its value, as other real property is taxed."

<sup>13</sup> Except for the provisions in the 1926 amendment relating to the fourth tax alternative, the 1926 and 1923 amendments are practically the same in substance. See *infra* n. 14.

<sup>14</sup> The 1926 Amendment of Section 5219 reads as follows: "The legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations located within its limits. The several States may (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, provided the following conditions are complied with:

"1. (a) The imposition by any State of any one of the above four forms of taxation shall be in lieu of the others, except as hereinafter provided in subdivision (c) of this clause.

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

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

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

"2. The shares of any national banking association owned by nonresidents 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 nonresident shareholders.

to certain conditions, to (1) tax the shares of national banks to their owners; or (2) include the dividends therefrom in the taxable income of the owners or holders thereof; or (3) tax the banks on their net income; or (4) tax the banks according to, or measured by, their net income.

What is the constitutional basis of these statutes? What right have the states to take advantage of the consent given by Congress to state taxation of a federal instrumentality? We have the court flatly declaring in *McCulloch v. Maryland* that the states cannot tax the operations of national banks but can tax the real property thereof and also the interests of shareholders therein. We have the later cases flatly declaring that the states cannot tax even the interests of shareholders without express consent of Congress. If, however, *McCulloch v. Maryland* be read in the light of the facts of the case and the principles involved be kept in mind, it is believed that there is no inconsistency between the cases, and that the present state of the law is fairly clear.

If the states do not have the power to tax national banks beyond the extent to which Congress may have consented, they lack the power, not simply because Congress has not given it to them, but because Congress by not consenting to the exercise of the power has implied an affirmative intent to prohibit it. It is apparent that the theory that the states derive their power to tax national banks from a grant by Congress cannot be sustained if it means that Congress has granted a power which is by the Constitution delegated exclusively to the federal government or prohibited to the states by that instrument.<sup>15</sup> But there is another

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

"4. The provisions of section 5219 of the Revised Statutes of the United States as heretofore in force shall not prevent the legalizing, ratifying, or confirming by the States of any tax heretofore paid, levied, or assessed upon the shares of national banks, or the collecting thereof, to the extent that such tax would be valid under said section." 44 STAT. 223 (1926).

<sup>15</sup>In view of the fact that the division of power between the federal government and the states is fixed by the Constitution, it is difficult to explain how that division can constitutionally be altered simply by action or inaction of the federal or state governments. So far as the federal Constitution is concerned, the states may pass any law whatever that is not expressly or impliedly prohibited by that instrument. If that be true, how can any power be given to the states by Congressional action or inaction without amending the Constitution? It has been suggested that although Congress cannot delegate powers to the state, yet, inasmuch as the bank is the creature of Congress and has only such powers and privileges as Congress chooses to endow it with, and since Congress can therefore create banks with or without any particular power or privilege, it must follow that Congress can confer any such power or privilege subject to limitations, conditions or burdens such as susceptibility to state taxation. Submission to taxation by the states in the manner set forth in the statute might therefore be considered

explanation of the theory. The Constitution delegates certain powers to the federal government and gives Congress power to pass all laws necessary and proper to carry those powers into effect, including power

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a condition precedent to the right to exercise the powers and privileges of a national bank: "Were we to admit, for the sake of the argument, this to be a tax of the bonds or capital stock of the bank, it is but a tax upon the new uses and new privileges conferred by the charter of the association; it is but a condition annexed to the enjoyment of this new use and new application of the bonds; and if Congress possessed the power to grant these new rights and new privileges, which none of the learned counsel has denied, and which the whole argument assumes, then we do not see but the power to annex the conditions is equally clear and indisputable. . . . The tax is the condition for the new rights and privileges conferred upon these associations." Mr. Justice Nelson in *Van Allen v. Assessors* (1865) 70 U. S. (3 Wall.) 573, 583. This argument, however, would be unsound if it meant that Congress may in this manner confer a power upon the states which the Constitution prohibits to the states or grants exclusively to the federal government. Suppose the incorporators of the bank agree to the condition and the charter is granted. Suppose further that a state levies a tax according to the terms of the condition. If the bank or taxpayer refuses to pay the tax because of a lack of power in the state to levy the tax, what right has the state to set up the condition as a justification for an exercise of power impliedly prohibited to it by the Constitution? If the Constitution prohibits the power to the state, it makes no difference whether Congress also prohibits it or expressly refuses to prohibit it. It is true that according to the condition on which the bank was chartered it agreed to submit to certain state taxes, but is not the state without authority to pass the laws necessary to enable it to take advantage of the condition? It might be argued that although the state has no authority to pass the law, the bank is estopped by the condition to deny the state's authority. Such an argument seems tantamount to saying that if the bank wants a charter it must consent to an unconstitutional condition and would seem to be met by a line of reasoning similar to that of recent cases which deny the states power to impose unconstitutional conditions upon foreign corporations desiring to do an intra-state business within their limits. *Terral v. Burke Construction Co.* (1922) 257 U. S. 529, 42 Sup. Ct. 188. See also *Western Union Telegraph Co. v. Kansas* (1910) 216 U. S. 1, 30 Sup. Ct. 190; *Michigan Public Utilities Commission et al. v. Duke* (1925) 266 U. S. 570, 45 Sup. Ct. 191; *Frost v. R. R. Commission* (1926) 271 U. S. 583, 46 Sup. Ct. 605. And if inaction or submissiveness of the federal government itself cannot constitutionally give the states power, how can inaction or submissiveness of a federal agency or instrumentality constitutionally confer power upon the states?

Mr. Justice Nelson, however, in the *Van Allen* case, recognized an original right in the states to tax national bank shares. The power is, according to his opinion, one that both Congress and the states have: a concurrent power, from the exercise of which Congress may, by reason of its paramount authority, exclude the states, or in the exercise of which, Congress for the same reason may restrict the states: "It is said that Congress possesses no power to confer upon a State authority to be exercised which has been exclusively delegated to that body by the Constitution, and, consequently, that it cannot confer upon a State the sovereign right of taxation; nor is a State competent to receive a grant of any such power from Congress. We agree to this. But as it respects a subject-matter over which Congress and the States may exercise a concurrent power, but from the exercise of which Congress, by reason of its paramount authority may exclude the States, there is no doubt Congress may withhold the exercise of that authority and leave the States free to act. An example of this relation existing between the Federal and State governments is found in the pilot laws of the States, and the health and

to create and maintain instrumentalities designed to carry those powers into effect. It makes such laws the supreme law of the land. National banks are such instrumentalities. *McCulloch v. Maryland* laid down an unquestionable principle when it said that if the states had power whether by taxation or otherwise, to destroy or hamper the effectiveness of such federal instrumentalities, the provisions of the Constitution paraphrased above would be idle and meaningless. On the basis of that principle it held void a tax levied by a state upon the operations of a federal instrumentality, because such a tax would hamper the function

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quarantine laws. The power of taxation under the Constitution as a general rule, and as has been repeatedly recognized in adjudged cases in this court, is a concurrent power. The qualifications of the rule are the exclusion of the States from the taxation of the means and instruments employed in the exercise of the functions of the Federal Government." 70 U. S. (3 Wall.) 573, 585. But if the concurrent theory of the Van Allen case were adopted, the taxing powers of the states could be utterly destroyed, inasmuch as the taxing powers of Congress are practically unlimited. "That the authority conferred upon Congress by § 8 of Article I 'to lay and collect taxes, duties, imposts and excises' is exhaustive and embraces every conceivable power of taxation has never been questioned, or, if it has, has been so often authoritatively declared as to render it necessary only to state the doctrine." Chief Justice White in *Brushaber v. Union Pacific R. R. Co.* (1916) 240 U. S. 1, 36 Sup. Ct. 236, 239. A mere statement of the limitations upon the federal taxing power is sufficient to show that they alone would be insufficient, if the "concurrent" theory of the Van Allen case were followed, to prevent virtual extinction by Congress of the taxing power of the states. The limitations on the federal taxing power are as follows: "all Duties, Imposts and Excises shall be uniform throughout the United States." U. S. Constr., Art. I, § 8. "No Capitation, or other direct, tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U. S. Constr., Art. I, § 9. Instrumentalities of the states cannot be taxed. *Collector v. Day* (1870) 78 U. S. (11 Wall.) 113, 127. The salaries of the president (U. S. Constr., Art. II, § 1 (7)) and federal judges (U. S. Constr., Art. III, § 1; *Evans v. Gore* (1920) 253 U. S. 245, 40 Sup. Ct. 550; *Miles v. Graham* (1925) 268 U. S. 501, 45 Sup. Ct. 601) are not taxable. Other cases, moreover, seem to be directly opposed to the concurrent theory of the Van Allen case. The well-settled law seems to be that the power of the states and the nation to tax for the support of their own governments is co-extensive rather than concurrent. This power may be exercised at the same time and upon the same subjects by the United States and by the states "without any inconsistency or repugnancy." *Ward v. Maryland* (1870) 79 U. S. (12 Wall.) 418, 428. See also *Passenger Cases* (1849) 48 U. S. (7 How.) 283, 298-299 and *Lane County v. Oregon* (1859) 74 U. S. (7 Wall.) 71, 76-78. The meaning of "concurrent" as regards taxation is clearly and forcefully set forth in Marshall's opinion in *Gibbons v. Ogden* (1824) 22 U. S. (9 Wheat.) 1, 199, where it is said: "Congress is authorized to lay and collect taxes, etc., to pay the debts, and provide for the common defense and general welfare of the United States. This does not interfere with the power of the states to tax for the support of their own governments; nor is the exercise of that power by the states, an exercise of any portion of the power that is granted to the United States. In imposing taxes for state purposes, they are not doing what Congress is empowered to do. Congress is not empowered to tax for those purposes which are within the exclusive province of the states. When, then, each government exercises the power of taxation, neither is exercising the power of the other."

of that instrumentality, such, indeed, being the very purpose of the tax. The rest of the opinion dealing with this branch of the case, whatever its merit, is dictum. We start, then, with the proposition that Congress can create instrumentalities in aid of the exercise of its powers, and the states cannot interfere with the functioning of those instrumentalities. The bar to the operation of the states' taxing power is thus, not an express prohibition in the Constitution, but an implied limitation due to the potentiality of conflict with the exercise of federal power over the same subject.<sup>16</sup> The only limitation upon the power of Congress to create instrumentalities is that they promote in some degree the fulfillment of the purpose of Congress in exercising its powers.<sup>17</sup> If a tax free instrument is, in the opinion of Congress, necessary to carry out those purposes, Congress may so declare; if it believes those purposes may be carried out by an instrument subject to state taxation it may likewise so declare. If Congress has created an instrument and expressly withheld from that instrument an immunity from state taxation, there is no conflict with an exercise of federal power, and the states' general tax laws of course take effect.<sup>18</sup> Section 5219 should, therefore, be con-

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<sup>16</sup> *Railroad Company v. Peniston* (1873) 85 U. S. (18 Wall.) 5, 36: "It is, therefore, manifest that exemption of Federal agencies from State taxation is dependent, not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but upon the effect of the tax; that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power."

<sup>17</sup> *McCulloch v. Maryland*, *supra* n. 6; *Osborne v. Bank of United States* (1824) 22 U. S. (9 Wheat.) 738; *First National Bank v. Fellows* (1917) 244 U. S. 416, 37 Sup. Ct. 734; *Missouri ex rel. Burnes Nat. Bank v. Duncan* (1924) 265 U. S. 17, 44 Sup. Ct. 427.

<sup>18</sup> That the states may regulate national banks so far as such regulation does not conflict with express provisions of Congressional legislation or with the purposes thereof has been definitely established by numerous decisions of the Supreme Court. It is submitted that there is no real distinction between the principle of these cases and the principle underlying state taxation of national banks. For cases in which state regulation has been upheld in absence of conflicting federal legislation, see *McClellan v. Chipman* (1896) 164 U. S. 347, 17 Sup. Ct. 85 (state statute invalidating assignments in fraud of creditors upheld as to preferences given national banks); *Waite v. Dowley* (1877) 94 U. S. 527 (state statute upheld requiring cashiers of national banks within the state to transmit to clerks of the several towns in the state a list of the names of its shareholders with the number of their shares); *First National Bank in St. Louis v. State of Missouri* (1924) 263 U. S. 640, 44 Sup. Ct. 213 (upheld right of Missouri to enforce as against national banks a state statute prohibiting the establishment of branch banks). In this case, Mr. Justice Sutherland, delivering the opinion of the court, declared, "Having determined that the power sought to be exercised by the bank finds no justification in any law or authority of the United States, the way is open for the enforcement of the state statute. In other words, the national statutes are interrogated for the sole purpose of ascertaining whether anything they contain constitutes an impediment to the enforcement of the state statute, and the answer

sidered an express declaration by Congress that certain types of state taxation will not be deemed an interference with the purpose of Congress in creating national banks, and an implied<sup>19</sup> declaration that all

being in the negative, they may be laid aside as of no further concern." 263 U. S. at 660, 44 Sup. Ct. at 216.

For cases in which state laws have been held inoperative as regards national banks because in conflict with the provisions or purposes of federal legislation, see *Mechanics' National Bank v. Dearing* (1875) 91 U. S. 29 (state statute providing that obligations carrying a usurious interest rate should be wholly void held inapplicable to national banks because National Banking Act provided that in such cases only the interest should be forfeited). The power of the state to regulate contracts made by national banks was recognized but, in the words of the court, "whenever the will of the nation intervenes exclusively in this class of cases, the authority of the State retires and lies in abeyance until a proper occasion for its exercise shall recur." *Davis v. Elmira Savings Bank* (1896) 161 U. S. 275, 16 Sup. Ct. 502 (New York statute providing that deposits of savings bank in any bank which should become insolvent should constitute a preferred claim held invalid as to deposits of savings banks in national banks because National Banking Act required the assets of an insolvent national bank to be distributed ratably among the creditors); *First National Bank of San Jose v. California* (1923) 262 U. S. 366, 1030, 43 Sup. Ct. 602 (California statute providing for escheat to state of bank deposits remaining totally inactive for twenty years or more held invalid as regards national banks as an interference by the state in the relations of the banks with their depositors and impairing efficiency of the banks).

<sup>19</sup> See also *Shaw v. Gibson-Zahniser Oil Corporation* (1928) 276 U. S. 575, 48 Sup. Ct. 333. In this case an Oklahoma tax on the production of oil was held valid as applied to oil from land bought by a Creek Indian under supervision of the Secretary of the Interior, although the Secretary had, apparently, attempted to exempt it from state taxation. Mr. Justice Stone, delivering the opinion of the court, declared:

"the lands now in question, and hence the interest of the lessee in them, are not such instrumentalities of the government as will be declared immune from taxation in the absence of an express exemption by Congress and that the mere act of the Secretary in imposing the restriction is not the exercise of any power which may reside in Congress to exempt them from taxation.

"What governmental instrumentalities will be held free from state taxation, though Congress has not expressly so provided, cannot be determined apart from the purpose and character of the legislation creating them. *Metcalf & Eddy v. Mitchell*, 269 U. S. 514. The end sought and the mode of attaining it adopted by Congress in the legislation providing for the welfare of the Indians by setting apart, by allotment or otherwise, tribal lands or the public domain, restricted for their benefit, led to the conclusion that those lands and the use of them were so intimately connected with the performance of governmental functions as clearly to require independence of all state control so complete that nothing short of an express declaration by Congress would have subjected them to state taxation.

"Governmental agencies similarly held to be exempt are national banks, *First National Bank of Hartford v. Hartford*, 273 U. S. 548; bonds of the national government, *Weston v. City Council of Charleston*, 2 Pet. 449, 467. . . . There are some instrumentalities which, though Congress may protect them from state taxation, will nevertheless be subject to that taxation unless Congress speaks. See *Goudy v. Meath*, 203 U. S. 146, 149; *Gromer v. Standard Dredging Co.*, 224 U. S. 362, 371; *Fidelity & Deposit Co. v. Pennsylvania*, 240 U. S. 319, 323; *Railroad Co. v. Peniston*, 18 Wall. 5; *Choctaw O. & G. R. R. v. Mackey*, 256 U. S. 531, 537; *Central Pac. R. R. v. California*, 162 U. S. 91, 126. These lands we take to be of that character."

other kinds and degrees of taxation will be deemed an interference with that purpose.

It is worthy of note that the solution found by Mr. Chief Justice Marshall in *McCulloch v. Maryland* does not decide the vital question dealt with in the theory above stated, and it is submitted, necessarily decided by the cases which recognize and give effect to Section 5219. Marshall first enlarged upon the constitutional necessity of operations of federal instruments being immune from state interference. He then stated the argument of the state that the power of the state to tax all things within its borders was a sovereign and unsundered power. Marshall solved the apparently irreconcilable conflict, not by denying the contention of the state, but by denying the conflict. He assumed and indeed admitted by implication the unrestrainable quality of the state's power to tax. But, said he, the state's power extends, not to everything within its borders, but to everything within its "sovereignty," and he held that instruments and operations of instruments placed within the borders of the state by the federal government exercising its supreme powers were not thereby placed within the "sovereignty" of the state. With this reasoning it was unnecessary to decide what would happen when those powers do in fact come into conflict. This is the question raised and dealt with above, and in the cases enforcing the provisions of Section 5219. Marshall assumed, no doubt correctly,<sup>20</sup> that the property of individuals in shares in a national bank was subject to the state's sovereign power of taxation. Section 5219 is undoubtedly an interference with that power, and the court enforces it. It seems therefore unquestionable that under the law as it now exists Congress may, within limits not yet defined,<sup>21</sup> for the purpose of protecting and

<sup>20</sup> See *supra* n. 15.

<sup>21</sup> In *National Bank v. Commonwealth* (1869) 76 U. S. (9 Wall.) 353, the Supreme Court, per Miller, J., in holding valid a state statute taxing shares of national banks, declared, "The principle . . . [of *McCulloch v. Maryland*] has its limitation, a limitation growing out of the necessity on which the principle itself is founded. That limitation is, that the agencies of the Federal government are only exempted from State legislation, so far as that legislation may interfere with, or impair their efficiency in performing the functions by which they are designed to serve that government. Any other rule would convert a principle founded alone in the necessity of securing to the government of the United States the means of exercising its legitimate powers, into an unauthorized and unjustifiable invasion of the rights of the States." And somewhat further on in the opinion it is stated: "They [national banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional. We do not see the remotest probability of this, in their being required to pay the tax which their stockholders owe to the State for the shares of their capital stock, when the law of the Federal government authorizes the tax."

fostering its lawful instruments, restrict the exercise of some of the sovereign powers of the states, among them the taxing power. The states may exercise their taxing powers until such exercise impinges upon and interferes with a use by Congress, for its lawful purposes, of the object taxed, when, because of the supremacy clause of the Constitution, the states must give way.

With respect to the point which Marshall actually decided, namely, that a state tax upon the operations of a federal instrument was void, it was unnecessary for him to decide whether such a tax was absolutely void: whether it would be void even though Congress consented. The exuberance of his rhetoric suggests that his condemnation of such a tax was unqualified, but it is submitted that the Constitution does not justify such a result. The tax is inoperative simply because the court implies from Congressional silence that Congress deems a tax free instrument necessary to carry out the purposes of Congress in creating that instrument. If the view of the nature of federal instruments set out above be correct, then it is difficult to see how any kind or degree of subjection of such instruments to state taxation could be unconstitutional *per se*. One may possibly imagine an instrument so hampered and emasculated by state taxation, to which Congress had rendered it vulnerable, that it would be completely incapable of performing any lawful purpose. But even in this remote contingency the statute creating the instrument or authorizing the taxes, if it was void, would be so, not because Congress had delegated any of its power to the states, but because Congress had as a matter of fact created an instrument which was worthless and therefore not an instrument authorized by the Constitution. In other words, it seems clear that no kind or degree of consent to taxation of a federal instrument could be anything more than a limitation of the powers of the instrument. It could never be a delegation of federal powers. A grant of power to tax and therefore interfere with an instrument created to subserve a federal power is not power to interfere with the power subserved and could not possibly be considered a grant of it.

In view of the foregoing discussion it is submitted that it makes no difference to the validity or effect of Section 5219 that some of its provisions may, or may be argued to, restrict the taxing power of the states and that others may allow that power to operate directly upon the instrument or its operations.

## II. WHAT IS "OTHER MONEYED CAPITAL IN THE HANDS OF INDIVIDUAL CITIZENS"

### A. "OTHER MONEYED CAPITAL" IS NOT CONFINED TO CAPITAL INVESTED IN BANKS

Section 5219 of the United States Revised Statutes has an extremely interesting history. The statute, it will be recalled, provides, and has always provided, that the taxation of national bank shares "shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens . . ." The judicial history of this section has been written around attempts of the courts to explain the key words, "other moneyed capital in the hands of individual citizens." This phrase has never ceased to puzzle legislators, judges, and taxpayers in spite of the fact that the Supreme Court has several times attempted comprehensively to define its import. That capital invested in state banks is "other moneyed capital" is obvious.<sup>22</sup> It has been strongly contended, in fact, that the Congress which passed the measures that later became Section 5219 intended the words to refer only to the stocks in state banks and not to personal investments.<sup>23</sup> The United States Supreme

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<sup>22</sup> *Mercantile Bank v. N. Y.* (1887) 121 U. S. 138, 7 Sup. Ct. 826; *City Bank v. Paducah* (C. C. D. Ky. 1877) Fed. Cas. No. 2743.

<sup>23</sup> The first (1864) restrictive act of Congress contained three express limitations on the state's power to tax national bank shares. See *supra* n. 11. Two of these restrictions were as follows: (1) The rate imposed on national bank shares must not be greater than that assessed upon other moneyed capital in the hands of individual citizens; (2) The tax on national bank shares must not exceed that imposed on state bank shares. The contention that Congress meant to refer to state bank shares only would seem to render superfluous the first restriction. As a matter of fact, however, the second restriction was actually considered superfluous, as it was omitted from the reenactment of the statute in 1868. It might be argued that the two limitations in the 1864 act were identical in meaning and that one of them, it was a matter of indifference which one, was superfluous so that no particular significance should be attached to omitting the second restriction rather than the first, inasmuch as either referred only to state bank shares. This argument, however, seems unsound, for if Congress had in fact considered the general and the specific restriction to be identical in meaning it would, it seems safe to say, have omitted the former. The Supreme Court reached this conclusion in *Boyer v. Boyer* (1885) 113 U. S. 689, 691, 5 Sup. Ct. 706, 707:

"But the act of 1864 was so far modified by that of February 10, 1868, 15 Stat. 34, ch. 7, that the validity of such State taxation was thereafter to be determined by the inquiry, whether it was a greater rate than was assessed upon other moneyed capital in the hands of individual citizens, and not necessarily by a comparison with the particular rate imposed upon shares in State banks. The effect, if not the object, of the latter act was to preclude the possibility of any such interpretation of the act of Congress as would justify States, while imposing the same taxation upon national bank shares as upon shares in State banks, from discriminating against national bank shares, in favor of moneyed capital not invested in State bank

Court, however, when the matter has been presented to it, has not hesitated to give the words a much broader meaning than capital invested in state banks.

The first case broadly to interpret the statute was *People v. Weaver*.<sup>24</sup> A New York statute, construed by the New York Court of Appeals as not permitting holders of national bank shares to make the same deductions for debts it allowed to those who had moneyed capital otherwise invested, was held to conflict with Section 5219. National and state bank shares were taxed equally, no deduction being allowed from either, so the case clearly stands for the proposition that moneyed capital within the meaning of the statute included capital other than that invested in banks. In *Evansville National Bank v. Britton*<sup>25</sup> the court held invalid an Indiana statute which permitted deduction of debts from "credits" but not from bank stock and other personal property. It was argued that the Indiana statute was to be distinguished from the New York statute held invalid in *People v. Weaver* in that the former allowed deduction of debts only from "credits," whereas the latter allowed the deduction from all personal property except bank stock. The court was of the opinion, however, that the nature of the discrimination was just as important as the extent thereof and that of all kinds of personal property, "credits" were, perhaps, most clearly "other moneyed capital":

"The Act of Congress does not make the tax on personal property the measure of the tax on bank shares in the State but the tax on moneyed capital in the hands of the individual citizens. Credits, money loaned at interest, and demands against persons or corporations are more purely representative of moneyed capital than personal property, so far as they can be said to differ."<sup>26</sup>

The *Weaver* case was again followed and its principle extended in *Boyer v. Boyer*,<sup>27</sup> in which the court gives the broadest interpretation which has ever been given Section 5219. The case was as follows. A Pennsylvania statute removed the burden of local taxation "from all bonds or certificates of loan issued by any railroad company incor-

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stock. At any rate, the acts of Congress do not now permit any such discrimination."

In spite of this decision the conclusion that Section 5219 applied only to state banking associations was reached in 1919 by the Virginia court in *Merchants National Bank v. Richmond* (1919) 124 Va. 522, 98 S. E. 643. The United States Supreme Court reversed the decision. Mr. Justice Pitney, delivering the opinion of the court quoted from and adopted the reasoning of the *Boyer* case quoted above.

<sup>24</sup> (1879) 100 U. S. 539.

<sup>25</sup> (1882) 105 U. S. 322.

<sup>26</sup> 105 U. S. 322, 324.

<sup>27</sup> (1885) 113 U. S. 689, 5 Sup. Ct. 706.

porated by the State; from shares of stock in the hands of stockholders of any institution or company of the State, which, in its corporate capacity, is liable to pay a tax into the State treasury under the Act of 1859; from mortgages, judgments and recognizances of every kind; from moneys due or owing upon articles of agreement for the sale of real estate; from all loans however made by corporations which are taxable for State purposes when such corporations pay into the State treasury the required tax on such indebtedness." The case arose on an injunction to restrain the levy of a county tax on shares of stock in a national bank. The county demurred to the bill setting forth the exemptions allowed by the state laws above quoted, and contended that the fact that a large amount of personal property other than bank shares was exempt from taxation was immaterial in that such exemptions did not include the shares of state banks and savings institutions. The Supreme Court of Pennsylvania sustained the demurrer, on the ground that national bank shares were not taxed in any different manner nor at a higher rate than other capital of a similar character. The United States Supreme Court, however, reversed the decision, holding that the state court had failed correctly to interpret the meaning of Section 5219. The court declared that

"Capital invested in national bank shares was intended to be placed upon the same footing of substantial equality in respect of taxation by State authority as the State establishes for other moneyed capital in the hands of individual citizens, *however invested, whether in State bank shares or otherwise.*"<sup>28</sup>

The contention was made that public policy demanded that railroad securities and the stocks and bonds of certain other corporations which were liable to taxation for state purposes only should be exempt from local taxation inasmuch as the principal revenues of the state were derived from these sources. It is apparent from the answer of the court to this contention that such capital was deemed to be within the meaning of Section 5219:

"It is quite sufficient in respect of such matters, to say that this court has no function to deal with the considerations of public policy which control that Commonwealth in the assessment of property for purposes of revenue. . . . If the principle of substantial equality of taxation under State authority, as between capital so invested and other moneyed capital in the hands of individual citizens however invested, operates to disturb the peculiar policy of some of the states in respect of revenue derived from taxation, the remedy therefor is with another department of the government, and does not belong to this court."<sup>29</sup>

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<sup>28</sup> 113 U. S. 689, 702. Italics added.

<sup>29</sup> 113 U. S. 689, 702.

No limitation whatever seemed to be put upon the meaning of the words "other moneyed capital." All capital, the value of which is measured in terms of money, was apparently included within the scope of Section 5219. Although, as will presently appear, this holding was somewhat modified in later decisions, the proposition that "other moneyed capital" is confined to capital invested in banks has never been sustained by the Supreme Court.

B. "MONEYED CAPITAL" AS USED IN SECTION 5219 MEANS ANY  
CAPITAL THAT COMPETES WITH THE BUSINESS OF  
NATIONAL BANKS

The court very soon withdrew from the broad position taken in *Boyer v. Boyer*. In *Mercantile National Bank v. Mayor etc. of New York*,<sup>30</sup> a case of outstanding significance, the court very definitely limited the rule of the *Boyer* case. The phrase "other moneyed capital" was held to refer not to any kind of money capital but only to capital in the hands of individual citizens that competed with the business of national banks. In other words, "moneyed capital" was deemed to be capital employed in a manner similar to that in which banks employ their money, *i. e.*, where the object of the enterprise is to make a profit by the use of the capital as money. "The moneyed capital thus employed is invested for that purpose in securities by way of loan, discount, or otherwise, which are from time to time according to the rules of business, reduced again to money and reinvested." It was not the intention of Congress to interfere with the states' taxing policies with regard to business activities that did not compete with national banks. As the court says in one of the most oft-quoted portions of its opinion, "The main purpose . . . of Congress, in fixing limits to state taxation on investments in the shares of national banks, was to render it impossible for the state, in levying such a tax, to create and foster an unequal and unfriendly competition, by favoring institutions or individuals carrying on a similar business and operations and investments of a like character. The language of the Act of Congress is to be read in the light of this policy."<sup>31</sup> The apparently almost unlimited scope of the phrase "other moneyed capital" as interpreted in the *Boyer* case is thus unequivocally repudiated and in its place a purposive rather than a merely literal connotation is adopted.

The court then examined the context of the phrase and found therein further aid in determining its meaning:

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<sup>30</sup> (1887) 121 U. S. 138, 7 Sup. Ct. 826.

<sup>31</sup> 121 U. S. 138, 155.

"Applying this rule of construction, we are led, in the first place, to consider the meaning of the words 'other moneyed capital,' as used in the statute. Of course it includes shares in national banks; the use of the word 'other' requires that. If bank shares were not moneyed capital, the word 'other' in this connection would be without significance."

In other words, when Congress says that national bank shares shall not be taxed at a higher rate than "other moneyed capital" it necessarily says that *national bank shares* are "moneyed capital," for if they were not, then the other capital spoken of would not be "other" moneyed capital but simply "moneyed capital." One might conclude, therefore, that by "other" moneyed capital Congress must have meant only capital, which like national bank shares, was "moneyed capital," but which was not national bank shares (since it was "other") but shares in banks not national, namely, state banks. This conclusion, however, would be unquestionably wrong. By calling national bank shares moneyed capital, Congress undoubtedly called shares in similar state banks moneyed capital. But Congress could imply that all bank shares are moneyed capital without implying that all moneyed capital is bank shares. The court, quite properly, therefore, inquired further into the scope of "other moneyed capital" on the basis of the purposive definition which it had formulated:

"But 'moneyed capital' does not mean all capital the value of which is measured in terms of money. In this sense, all kinds of real and personal property would be embraced by it, for they all have an estimated value as the subjects of sale. Neither does it necessarily include all forms of investment in which the interest of the owner is expressed in money. Shares of stock in railroad companies, mining companies, manufacturing companies, and other corporations, are represented by certificates showing that the owner is entitled to an interest, expressed in money value, in the entire capital and property of the corporation, but the property of the corporation which constitutes its invested capital may consist mainly of real and personal property, which, in the hands of individuals, no one would think of calling moneyed capital, and its business may not consist in any kind of dealing in money, or commercial representatives of money."<sup>32</sup>

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<sup>32</sup> *Ibid.* So far as concerns the policy of the national government with reference to national banks it is a matter of indifference, the court declared, how the corporations just mentioned, or the interests of individuals in them, are taxed. Whether such interests are taxed has no effect in the contemplation of the law upon the success of the national banks. The court has definitely held that corporations engaged in the following business enterprises are not considered in competition with national banks and hence such corporations or shares of stock therein may be exempt in whole or in part from taxation, as far as Section 5219 is concerned:

*Mining Companies.* Talbott v. Silver Bow County Commissioners (1890) 139 U. S. 438, 11 Sup. Ct. 594.

*Gas Companies.* First National Bank of Aberdeen v. County of Chehalis (1897) 166 U. S. 440, 17 Sup. Ct. 629.

In other words, the test is not whether the thing specially favored by the state's taxing laws is or is not capital in the form of money, or measured in terms of money, but whether it is capital employed in

*Telephone Companies.* Bank of Redemption v. Boston (1887) 125 U. S. 60, 8 Sup. Ct. 772.

*Building and Loan Associations.* Davenport Bank v. Davenport Board of Equalization (1887) 123 U. S. 83, 8 Sup. Ct. 73; National Bank of Redemption v. Boston (1887) 125 U. S. 60, 8 Sup. Ct. 772; Mercantile National Bank of Cleveland v. Hubbard (1899) 98 Fed. 465.

*Insurance Companies.* People v. Commissioners (1866) 71 U. S. (4 Wall.) 244; Bank of Redemption v. Boston (1887) 125 U. S. 60, 8 Sup. Ct. 772.

*Savings bank deposits* have been held not to come within the application of Section 5219 because public policy favors the encouragement of savings banks and because they do not compete with the distinctively commercial operations of national banks. Mercantile National Bank v. New York, *supra* n. 22; Bank v. Board of Equalization (1887) 123 U. S. 83, 8 Sup. Ct. 73; Bank of Redemption v. Boston (1887) 125 U. S. 60, 8 Sup. Ct. 772; Mercantile National Bank v. Hubbard (N. D. Ohio, 1889) 98 Fed. 465.

*Trust Companies.* In the Mercantile Bank case, *supra* n. 22, the court declared that under the laws of New York at that time trust companies were not banks in the "commercial sense of that word and do not perform the functions of banks in carrying on the exchanges of commerce. They receive money on deposit, it is true, 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. But we fail to find in the record any sufficient ground to believe that the rate of taxation, which in fact falls upon this form of investment of moneyed capital, is less than that imposed upon shares of stock in national banks." 121 U. S. 138.

In *Jenkins v. Neff* (1902) 186 U. S. 230, 22 Sup. Ct. 905, it was claimed that, although the laws of New York did not permit trust companies to engage in the banking business, they were in fact doing such business. The court held that, 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, and that investments in trust companies were not competitive with national banking capital, even though such companies did temporarily compete because of their illegal acts. This holding was expressly repudiated by the court in *First National Bank v. Hartford* (1927) 273 U. S. 548, 552, 47 Sup. Ct. 462: "The question [of competition within the meaning of Section 5219] is thus a mixed one of law and fact, and in dealing with it we may review the facts in order correctly to apply the law. The opposite view expressed in *Jenkins v. Neff*, 186 U. S. 230, must be considered discarded by the later cases." By *dictum* in *Amoskeag Savings Bank v. Purdy* (1913) 231 U. S. 373, 34 Sup. Ct. 114, trust companies were assumed to be competing with national banks. From these *dicta* it seems safe to assume that investments in trust companies exercising the powers admittedly exercised by the companies in *Jenkins v. Neff* would now be considered "other moneyed capital" and within the restrictions of Section 5219.

It is important also to note that national banks are now permitted to do a trust business, subject to certain statutory limitations. FEDERAL RESERVE ACT, 38 STAT. 251, 262 (1913), 12 U. S. C. § 248 (1926). The Supreme Court in upholding this statute gave as one of the reasons for its decision the fact that trust companies actually compete with the business of national banks. *First National Bank of Bay City v. Fellows* (1917) 244 U. S. 416, 425, 37 Sup. Ct. 734. See also *Missouri ex rel. Burnes Nat. Bank v. Duncan*, *supra* n. 17.

the same kind of transactions in which national banks engage. The question naturally arises at this point, what are the transactions in which national banks engage? The court's answer to this question is one of the most important parts of its opinion, for individuals or institutions which perform any of these operations cannot with regard thereto be given advantages in the matter of taxation that are not extended to owners of national bank shares:

"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, and it is the nature of that employment which constitutes it in the eye of this statute 'moneyed capital'."<sup>33</sup>

Regardless of the clear and definite holding of *People v. Weaver* and *Boyer v. Boyer* and the detailed opinion of the court in *Mercantile National Bank v. New York* to the effect that "other moneyed capital" as used in Section 5219 was not confined to capital invested in banks, the states failed to provide in their tax statutes for equality of taxation of individually owned "moneyed capital" and capital invested in banks. Some states, including California, authorized a separate classification of all intangible property except bank shares for low rate taxation. In view of the cases mentioned it is surprising that it was not until 1921 that the Supreme Court was called upon to hold invalid such favored treatment of intangibles. In that year in *Merchants National Bank v. Richmond*,<sup>34</sup> the most important case on this subject since the *Mercantile Bank* case, the Supreme Court held invalid a state law and municipal ordinance taxing national bank shares, on the ground that bonds, notes and other evidences of indebtedness in the hands of individual citizens were taxed at a lower rate than were bank shares. The State of Virginia and the City of Richmond, by statute and ordinance, imposed a tax for state purposes at the rate of 35 cents and a tax for city purposes at the rate of \$1.40—a total of \$1.75 upon the \$100 of valuation—upon shares of stocks in state and national banks. Upon intangible property in general, including bonds, notes and other evidences of indebtedness the state rate was 65 cents and the city rate 30 cents, an aggregate of 95 cents upon each \$100 of valuation. The \$1.75 rate was imposed upon national bank stocks to the aggregate value of

<sup>33</sup> 121 U. S. 138, 156.

<sup>34</sup> *Supra* n. 1.

more than \$8,000,000, and upon the stocks of state banks and trust companies to the value of \$6,000,000 and upwards, while the lower rate was imposed upon bonds, notes and other evidences of indebtedness aggregating \$6,250,000. The court asserted that it was shown by evidence without dispute that moneyed capital in the hands of individuals invested in bonds, notes and other evidences of indebtedness comes into competition with the national banks in the loan market. It was the opinion of the Virginia Supreme Court of Appeals that the purpose of Section 5219 was confined to the prevention of discrimination by the state in favor of state banking associations against national banking associations and that therefore there was no repugnance of the Virginia taxes to that section. The United States Supreme Court reiterated and elaborated upon its earlier holdings that this is too narrow a view of the meaning of Section 5219, stating:

"By repeated decisions of this court, dealing with the restriction here imposed, it has become established that, while the words 'moneyed capital in the hands of individual citizens' do not include shares of stock in corporations that do not enter into competition with the national banks, they do include something besides shares in banking corporations and others that enter into direct competition with those banks. They include 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.*"<sup>35</sup>

Immediately following the decision in the *Richmond* case, banks in all parts of the country brought suits to test the validity of state tax laws according special privileges to intangible property. The *Richmond* decision also led to the amendment of Section 5219 in 1923. The section was reenacted and after the words, "other moneyed capital in the hands of individual citizens," the following proviso was added:

"Provided that bonds, notes or other evidences of indebtedness in the hands of individual citizens not engaged or employed in the banking 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."<sup>36</sup>

It seems clear that the amendment was intended to be a proviso in the proper sense of the word, *i. e.*, was intended to except the types of capital enumerated from the operation of the section. That purpose might have been accomplished had the words "*not made in competition with such business*" been omitted. But when the section as reenacted

<sup>35</sup> 256 U. S. 635, 639. Italics added.

<sup>36</sup> 42 STAT. 1499.

came before the Supreme Court in *National Bank v. Anderson*<sup>37</sup> the court interpreted the amendment as follows:

"The defendants say that this reënactment was intended as a legislative interpretation of the prior restriction, and that the proceedings resulting in its adoption so show. But, assuming that this is true, the situation is not changed; for the reënactment did no more than to put into express words that which, according to repeated decisions of this court, was implied before. In *Mercantile Nat. Bank v. New York*, *supra*, where the terms and purpose of the restriction were much considered, it was distinctly held that the words 'other moneyed capital' must be taken as impliedly limited to capital employed in substantial competition with the business of national banks. In later cases that definition was accepted and given effect as if written into the restriction . . . Thus in legal contemplation and practical effect the restriction was the same before the reënactment as after."<sup>38</sup>

The court thus held that the amendment was without any effect whatever. In general, interpretations of statutes which render them meaningless are not favored, and although the proviso is without doubt poorly worded, it is at least arguable that the court's interpretation is not justified.<sup>39</sup>

The Supreme Court has had occasion in several recent cases to reaffirm the position taken in the *Richmond* case. In view of these cases there can be no doubt whatever that individuals are competing

<sup>37</sup> *Supra* n. 1.

<sup>38</sup> 269 U. S. 341, 350.

<sup>39</sup> If the statute be read in the light of the fact that the amendment followed upon the heels of the *Richmond* case, in which the very variety of investments dealt with in the amendment were held to be within the restrictions of the statute, it seems unreasonable to question the proposition that the amendment was designed to change the rule of that case. See 64 CONG. REC. 4802-4803, 4959 (1923). It seems that the only justification for the decision nullifying the proviso would be that the language of the statute compelled the court to ignore the unquestionable intention of Congress in enacting it. It is well settled, of course, that statutes are thus interpreted only when no other interpretation is possible. Other interpretations were possible in this case. For example, it would seem quite possible to say that the words "not made in competition with such business" were intended to be parenthetical or argumentative rather than a genuine qualification of the types of investment enumerated.

The court held that the statute was merely declaratory. But if Congress was simply declaring the existing rule, its attempt to do so was indeed a very imperfect and misleading statement of the rule: a legislative attempt to enumerate all forms of capital falling under this rule would be futile, impossible and dangerous—dangerous because it would exclude all other forms of capital. It cannot be said that Congress intended in fact that its list be exhaustive, for it did not include the most obvious item, *i. e.*, shares in state banks. Unless, therefore, the proviso be treated as a meaningless jumble of words it must be said that Congress meant either to exclude from the operation of the statute the forms of capital enumerated or it meant to exclude all other forms. Since state bank shares were not listed, the latter alternative is untenable.

with national banks even though they make purely personal investments in bonds, notes and other forms of indebtedness.

In *First National Bank of Hartford v. Hartford*,<sup>40</sup> a rather belated attempt was made to confine the phrase "other moneyed capital" as used in Section 5219, to capital invested in banks. Under the laws of Wisconsin an *ad valorem* tax was imposed upon the shares of all banks as personal property within the assessment district in which the bank was located. All debts due to any person and all stocks and bonds were exempt from the *ad valorem* tax, but the income therefrom was taxed under a general income tax, which was assumed by the state court, and not questioned by the United States Supreme Court, as not to be the equivalent or substitute for the *ad valorem* tax levied upon bank shares. All persons doing a "banking business" in Wisconsin are required by statute to incorporate as banks, and their shares are taxed in the same way and at the same rate as shares in national banks, but the statute expressly limited its application to those engaged in "soliciting, receiving, or accepting of money or its equivalent on deposit as a regular business." There were individuals, firms and corporations in Wisconsin, not required by its laws to be incorporated as banks, engaged in an extensive business<sup>41</sup> of loaning money on the security of notes, bonds and mortgages and selling securities "all involving investment and re-investment by them and their customers." The state supreme court sustained the tax, holding that there was no capital in the hands of individual citizens which was invested or used in substantial competition with the capital invested in national banks shares, inasmuch as all persons doing a banking business were required to incorporate and were taxed on their shares in the same manner and at the same rates as national banks. The state court was thus apparently of the opinion that Section 5219 was not violated unless the tax favored persons engaged in "soliciting, receiving or accepting money or its equivalent on deposit as a regular business." But this activity constitutes only a part of the business of national banks. The United States Supreme Court refused to approve the narrow interpretation of Section 5219 by the Wisconsin court:

"The requirement of approximate equality in taxation is not limited to investment of money capital in shares of state banks or to competing capital employed in private banking. The restriction applies as well where the competition exists only with respect to particular features of the business of national banks or where moneyed capital is employed, substantially as in the loan and investment features of banking, in making investments

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<sup>40</sup> *Supra* n. 1.

<sup>41</sup> For discussion of burden of proving discrimination see *infra* p. 108 *et seq.*

by way of loan, discount or otherwise, in notes, bonds or other securities, with a view to sale or repayment and reinvestment'."

"Competition may exist between other moneyed capital and capital invested in national banks, serious in character and therefore well within the purpose of Section 5219, even though the competition be with some but not all phases of the business of national banks. Section 5219 is not directed merely at discriminatory taxation which favors a competing banking business. Competition in the sense intended arises not from the character of the business of those who compete but from the manner of the employment of the capital at their command."<sup>42</sup>

In *First National Bank of Guthrie Center v. Anderson*,<sup>43</sup> plaintiff national bank brought suit on behalf of its shareholders to restrain the collection of a tax against the latter on their shares. The complaint of the bank stated that in the town of Guthrie Center the total levy for local, county and state tax purposes on national bank shares was 143.5 mills on the dollar, whereas only 5 mills on the dollar was imposed upon "notes, mortgages and other evidences of debt, and investments of individuals in securities, *which represent money at interest*, and other evidence of indebtedness such as normally enter into the business of banking. . . . That the amount of notes, mortgages and other evidences of money loaned and put out at interest . . . was a very large sum, which amount plaintiff is unable to state; but upon information and belief plaintiff charges said amount to be more than \$5,000,000 . . . while the total of all bank stock, including state and national in Guthrie County, Iowa, does not exceed the sum of \$316,852." The defendant county officers charged with the duty of collecting the taxes interposed a general demurrer to the petition. The demurrer, sustained by the state court, was overruled by the United States Supreme Court on the ground that the discrimination charged in the petition on the authority of settled decisions, was in conflict with the restrictions of the federal statute. The state supreme court regarded the petition as alleging simply that notes and other evidences of moneyed loans, payment of which is secured upon farm lands, were taxed at a lower rate than bank shares. Moneyed capital loaned on farm mortgages, it was argued, was not to be regarded as loaned or invested in competition with national banks, inasmuch as state and national banks were the instrumentalities through which much the larger portion of farm loans were made, which were thus a source of profit to the bank: "Surely moneyed capital loaned and invested by banks, as the agents of their customers, cannot be said to be loaned in competition therewith. Competition means rivalry, and the loaning of money by national and other banks for

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<sup>42</sup> 273 U. S. 548, 556, 557.

<sup>43</sup> *Supra* n. 1.

individuals at a profit, or for the convenience of such owners is lacking in all the essentials of competition." The United States Supreme Court answered this contention as follows:

"We find . . . [in the allegations in the petition] no specific mention of farm mortgages, nor anything indicating that they refer only to such mortgages. No doubt they are broad enough to include farm mortgages; but this does not weaken the allegation of competition, for while national banks were formerly prohibited from making loans on real estate, Rev. Stat. §§ 5136, 5137; *Union National Bank v. Matthews*, 98 U. S. 621, 625; *National Bank v. Whitney*, 103 U. S. 99, the prohibition was partly withdrawn and much of that field was opened to such banks by the Acts of December 22, 1913, c. 6, § 24, 38 Stat. 273, and September 7, 1916, c. 461, 39 Stat. 754."<sup>44</sup>

This case apparently stands for the proposition that the extension of the power of national banks effects a corresponding extension of the field of business activities that compete with the business of national banks.

The court's concise summary of the restrictions upon state taxation of national banks forcibly and definitely sets out its present interpretation of Section 5219:

"1. The purpose of the restriction is to render it impossible for any state, in taxing the shares, to create and foster an unequal and unfriendly competition with national banks, by favoring shareholders in state banks or individuals interested in private banking or engaged in operations and investments normally common to the business of banking. *Mercantile National Bank v. New York*, 121 U. S. 138, 155; *Des Moines National Bank v. Fairweather*, *supra*.

"2. The term 'other moneyed capital' in the restriction is not intended to include all moneyed capital not invested in national bank shares, but only that which is employed in such way as to bring it into substantial competition with the business of national banks. *Mercantile National Bank v. New York*, *supra*; *Aberdeen Bank v. Chehalis County*, 166 U. S. 440, 461.

"3. Moneyed capital is brought into such competition where it is invested in shares of state banks or in private banking; and also where it is employed, substantially as in the loan and investment features of banking, in making investments, by way of loan, discount or otherwise, in notes, bonds or other securities with a view to sale or repayment and re-

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<sup>44</sup> The court dismissed the contention that the banks were really benefited by the system of farm loans as follows: "As the case now stands, we think no effect can be given to what the state court assumes is the practice of banks in rural portions of Iowa in making farm loans as agents for their customers or others. If there be such a practice, it is not a matter which may be noticed and given effect without pleading or proof. If followed by some banks it may not be followed by others. The state court does not speak of it as universal, but only as followed by 'many banks.' Certainly the record gives no ground for holding that the plaintiff follows it. In this situation the allegation of competition stands unaffected by the assumed practice." 269 U. S. at 354.

investment. *Mercantile National Bank v. New York*, *supra*; *Palmer v. McMahon*, 133 U. S. 660, 667, 668; *Talbott v. Silver Bow County*, 139 U. S. 438, 447.

"4. The restriction is not intended to exact mathematical equality in the taxing of national bank shares and such other moneyed capital, nor to do more than require such practical equality as is reasonably attainable in view of the differing situations of such properties. But every clear discrimination against national bank shares and in favor of a relatively material part of other moneyed capital employed in substantial competition with national banks is a violation of both the letter and spirit of the restriction. *People v. Weaver*, 100 U. S. 539; *Boyer v. Boyer*, 113 U. S. 689; *National Bank of Wellington v. Chapman*, 173 U. S. 205, 216."<sup>45</sup>

### III. WHAT IS A GREATER RATE?

If a state taxes national bank shares, "the tax shall not be at a *greater rate* than is assessed upon other moneyed capital . . ." The court has interpreted the words "at a greater rate" to be applicable not only to rates but to any discriminatory state taxation. The discriminatory character of a state tax is usually confined, however, to either the rates or the basis of assessment. If the valuation of national bank shares in proportion to their real value is higher than that of other moneyed capital the tax is as vicious as if the rates themselves had been discriminatory. Few cases simply involving unequal rates have reached the United States Supreme Court. Most of the cases have been brought before that court because of an alleged discrimination in the valuation of national bank shares. The following general situations presenting the problem of discrimination in the basis of assessment have arisen: (1) National bank shares have been taxed by entirely different methods of assessment from those used in taxing state banks and other moneyed capital; (2) taxpayers have been allowed by state law to deduct debts from credits but not from the valuation of national bank shares; (3) holders of "other moneyed capital" such as state bank shares have been allowed to deduct the value of federal tax exempt securities held by the state bank from the taxable value of the shares where owners of national bank shares were not allowed to do so; (4) holders of shares in a national bank have not been permitted to deduct taxes paid by the bank as a shareholder in another national bank, resulting in double taxation. A brief survey of the cases will show how the Supreme Court has met and solved the problems presented to it in each of the above situations.

Section 5219 does not require absolute equality of treatment of national bank shares and other moneyed capital in the hands of individual

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<sup>45</sup> 269 U. S. 341, 347-348.

citizens. Nor is any uniform rule prescribed as to the manner or mode of taxing national bank shares. If the actual tax burden on national bank shares is not in excess of the burden upon "other moneyed capital" the state may exercise its own independent judgment regarding its tax methods without fear of violating Section 5219.<sup>46</sup>

A national bank shareholder wishing to escape state taxation of his shares has the burden of proving discrimination in favor of "other moneyed capital." He must establish that a substantial amount<sup>47</sup> of capital favored by the state tax laws is employed in actual competition with the business of national banks. The rule as to proof of discrimination is emphatically set forth by the court in its opinion in *First National Bank of Garnett v. Ayers*:<sup>48</sup>

"In order to come to a decision in favor of the plaintiff in error, it would be necessary for this court to take . . . 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. . . . The relative proportions in which the moneyed capital of the State of Kansas is invested in the various kinds of securities to be therein found, this court cannot judicially know. When proof shall be made regarding this matter, it may then be determined intelligently whether . . . there has been a real discrimination against the holders of national bank shares."

However, in order to prove substantial competition it is not necessary to show that national banks and competing investors solicit the same customers for the same loans or investments. "It is enough . . . if both engage in seeking and securing in the same locality capital investments of the class now under consideration which are substantial in amount."<sup>49</sup>

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<sup>46</sup> See opinion of Brewer, J., dissenting in *San Francisco National Bank v. Dodge* (1905) 197 U. S. 70, 25 Sup. Ct. 384.

<sup>47</sup> In *Lionherger v. Rouse* (1870) 76 U. S. (9 Wall.) 468, discrimination in favor of a "substantial" amount of other moneyed capital was not proved by showing that two state banks by contract contained in their charter could be taxed only one per cent on their capital stock, which was less than the rate on national bank stock. In sustaining the tax the court said, "It is not denied that these two banks hold a very inconsiderable portion of the banking capital of the State, and that the shares of all other associations in the State (there being many), with all the privileges of banking . . . are taxed like the shares in National Banks." 76 U. S. (9 Wall.) 468, 474.

<sup>48</sup> (1896) 160 U. S. 660, 667, 16 Sup. Ct. 412. See also *Bank of Commerce v. Seattle* (1897) 166 U. S. 463, 464, 17 Sup. Ct. 996, which was quoted with approval by Pitney, J., who delivered the opinion of the court in *National Bank v. Richmond* (1921) 256 U. S. 635, 641, 41 Sup. Ct. 619.

<sup>49</sup> *First National Bank v. Hartford* (1927) 273 U. S. 548, 559, 47 Sup. Ct. 462.

*Georgetown National Bank v. McFarland*<sup>50</sup> is the latest case in which the Supreme Court refused to invalidate a state tax upon national bank shares because of lack of proof that a substantial amount of capital favored by state tax laws was employed in actual competition with the business of national banks. The state taxed money, notes, bonds and other credits for state purposes at a rate of 40c per \$100. National and state bank shares were subject to this tax and, in addition, to local taxation as well. There was thus a clear case of discrimination on the face of the law and it was contended by plaintiff bank that where all moneyed capital is exempt from local taxation except bank shares the law is void on its face without proof. The court rejected this contention and refused to invalidate it on the ground that "the evidence with respect to capital invested by individuals, taken as a whole, falls short of establishing that the capital thus used is employed substantially as in the loan and investment features of banking in making investments by way of loan or discount, or in notes, bonds, and other securities, with a view to sale or repayment and reinvestment."<sup>51</sup>

The shareholder has a more difficult task in establishing discrimination, when the state has one method for taxing national bank shares and different methods for taxing state banks and "other moneyed capital," than when the same method is used in taxing both. In *Davenport National Bank v. Board of Equalization*,<sup>52</sup> national bank shares were directly taxed, shares in state savings banks were not taxed but the capital of the savings banks was taxed directly at the same rate imposed on national bank shares. The court upheld the tax on the ground that it

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<sup>50</sup> (1927) 273 U. S. 568, 47 Sup. Ct. 467.

<sup>51</sup> 273 U. S. 568, 570. Mr. Justice Stone, who delivered the opinion of the court in this case, although affirming the decision of the state court, criticized its opinion for paying "more attention than we think justified to the difference between short-time and long-time loans and to the readiness with which the banks obtain loans, notwithstanding the competition alleged." This criticism is very interesting in view of the following and rather convincing argument of the state court: "It is shown by all the testimony that the banks made short-time loans, and that they decline to make loans on long time. It is also shown that the banks are lending to the limit and are rediscounting their paper in order to accommodate customers for a large part of the year. The moneyed capital of individuals is invested in notes given for the purchase-money of land or secured by mortgage on land running for a longer time than banks are willing to lend money for. It is not shown by anybody that any appreciable amount of money held by individuals is used in short-time loans, such as the banks made, and, this being true the capital invested in land notes and the like does not come into competition with the national banks, for they do not handle this character of paper." *McFarland v. Georgetown National Bank* (1925) 208 Ky. 7, 12, 270 S. W. 995, 997. Quoted by Lutz, 13 BULLETIN OF NATIONAL TAX ASSOCIATION (1928) No. 9, p. 265.

<sup>52</sup> (1887) 123 U. S. 83, 8 Sup. Ct. 73.

"did not satisfactorily appear from anything found in the record that this tax upon the moneyed capital of the savings banks is not as great as that upon the shares of stock in the national banks. It is not a necessary nor a probable inference from anything in this system of taxation that it should be so, and it is not shown by any actual facts in the record that it is so. If then, neither the necessary, usual or probable effect of the system of assessment discriminates in favor of the savings banks against the national banks upon the face of the statute, nor any evidence is given of the intention of the legislature to make such a discrimination, nor any proof that it works an actual and material discrimination, it is not a case for this court to hold the statute unconstitutional."<sup>53</sup>

In *San Francisco National Bank v. Dodge*<sup>54</sup> it was contended that a California law imposing a tax upon national bank shares but not upon the shares of state banks or other moneyed corporations was void on its face. State banks and corporations were taxed upon their property. The court held that no conflict necessarily arises between the act of Congress and the state law solely because the latter provides one method for taxation of state banks and other moneyed corporations and other methods for national banks. The court found the tax invalid, however, since national bank shares were taxed upon their full value which included the elements of value contributed by "good will, dividend earning power, the ability with which the corporate affairs were managed, the confidence reposed in the capacity and permanence of tenure of the officers, and all those other indirect and intangible elements of value which enter into the estimate of the worth of the stock and help to fix the market value or selling price of the shares," whereas the taxation of state banks on their property only did not include these intangible elements of value.<sup>55</sup>

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<sup>53</sup> The court then cites the opinion in *Mercantile Bank v. New York*, *supra* n. 22, that capital in savings banks was not in competition with national banking capital but finds it "unnecessary to inquire whether the savings banks of Iowa are based upon principles similar to those of New York which were the subject of the opinion in *Mercantile Bank v. New York*, for while in that case the savings banks were exempt from taxation, the Iowa statute imposes a tax upon them equal to that imposed upon the shares of national banks." 123 U. S. 83, 86.

<sup>54</sup> *Supra* n. 46.

<sup>55</sup> It is interesting to observe in the cases just discussed that in determining whether or not the state tax is discriminatory as to national bank shares the court does not compare the tax imposed on national bank shareholders with the tax burden on the state bank shareholders but with the tax on the state banks themselves. In other words, the states are allowed to set off the tax burden imposed on the state banks directly against the tax burden imposed on national bank shares. The states are thus allowed what seems a quite proper and harmless freedom in the method of taxing state banks. If the court were absolutely consistent and gave full force to the italicized portion of the phrase, "other moneyed capital *in the hands of individual citizens*," it would not translate a tax burden upon the state banks into a tax burden upon the interests of individual citizens in those banks. The court will not permit a direct tax upon a national bank to be translated into

An interesting problem of discrimination arising from difference in tax methods is presented by the New York case of *People ex rel. Hanover National Bank v. Goldfogle*<sup>56</sup> which involved the comparison of an *ad valorem* tax on national bank shares with an income tax on other moneyed capital. Bank shares, national and state, were taxed at one per cent of their book value. Individuals were taxed upon their gross income subject to certain exemptions at a rate of from one to three per cent. Dividends from bank stock were not included in the list of exemptions and the New York laws were therefore construed as taxing bank shares, both directly by the *ad valorem* tax and indirectly by the income tax levied on dividends received from the shares. As competing capital was taxed on income only there was a clear case of discrimination on the face of the statute. It is not clear from the opinion whether substantial discrimination was actually proved or whether the court took judicial notice of the fact that the amount of competing moneyed capital "was not inconsiderable" and "in the city of New York in the year 1921 . . . nearly twice the total capital of the state and national banks." The court went on to hold, however, that even aside from the fact that national bank stock was exempted from the income tax the *ad valorem* tax on national bank shares was invalid on the ground that "in no event would equality exist unless the income on competing capital

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a tax upon the bank's shareholders; should it do so when state banks are taxed? In *Owensboro National Bank v. Owensboro* (1899) 173 U. S. 664, 19 Sup. Ct. 537, it was urged that a tax upon the franchise of property of the plaintiff national bank was equivalent to a tax on the shares of stock in the names of the shareholders. The court, standing fast by the distinct entity theory, rejected this contention and held that the tax, being admittedly levied on the bank directly, was not within the purview of the authority conferred by Section 5219 and was therefore illegal. In the course of the opinion delivered by Mr. Justice White, it is said: "It cannot be doubted that, as a general principle, it is settled that the taxation of the property, franchises and rights of a corporation is one thing, and the taxation of the shares of stock in the names of the shareholder is another and different one. . . . It is unnecessary to multiply citations on this subject, as the question has been in recent cases reviewed and restated fully by the court." 173 U. S. 664, 681. If national banks and their shareholders are separate and distinct entities it would seem that state banks and their shareholders are equally separate and distinct. See Henry Rottschaefer, *State Taxation of National Bank Shares* (1923) 7 MINNESOTA L. REV. 357, 366.

As to the collection of any valid tax on shares of national banks, the banks may be required to pay the entire tax levied upon the shareholders, without invalidating the tax as one upon the banks, upon the theory that the bank is acting as the agent of the shareholders with a lien upon the shares and dividends as security for repayment of the tax. *First National Bank v. County of Cbehalis*, *supra* n. 32; *National Bank v. Ky.* (1869) 76 U. S. (9 Wall.) 353; *Merchants and Manufacturers Nat. Bank v. Penn.* (1897) 167 U. S. 461, 17 Sup. Ct. 829; *Home Savings Bank v. Des Moines* (1907) 205 U. S. 503, 27 Sup. Ct. 571.

<sup>56</sup> (1922) 234 N. Y. 345, 137 N. E. 611. Petition for writ of certiorari denied by United States Supreme Court (1923) 261 U. S. 620, 43 Sup. Ct. 432. For comment on this case see Note (1923) 8 CORNELL L. Q. 279.

were large beyond the dreams of avarice and the usual returns on investments."

"How can equality be established or presumed as the necessary result of the 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 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."<sup>57</sup>

The inequality arising from the New York laws is easily demonstrated. A 1% tax on a share of national bank stock of a book value of \$1000 is \$10. One thousand dollars of competing moneyed capital would have to bring in an income of \$333.33, or a return of 33 $\frac{1}{3}$ % on the investment to entitle the state to a \$10 tax at 3%, the highest rate imposed by the income tax law.<sup>58</sup>

One of the earliest forms of discrimination against national bank shares lay in the practice of permitting personal debts to be deducted from credits but not from the value of national bank shares. The court in *People v. Weaver*,<sup>59</sup> it will be recalled, held invalid as regards national bank shares a New York statute allowing debts to be set off against all forms of personal property except national and state bank shares. However, a shareholder cannot attack the statute unless he has debts to deduct.<sup>60</sup> Furthermore, if the state has different methods of taxing national bank shares from other moneyed capital it may allow deduction of debts from other moneyed capital and not from the value of bank shares if an actual discrimination is not proved.

In *Amoskeag Savings Bank v. Purdy*<sup>61</sup> the court was called upon to determine the validity of a New York statute which taxed national bank shares at a rate of one per cent on their book value (capital, surplus and undivided profits of the bank divided by the number of out-

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<sup>57</sup> 234 N. Y. 345, 354, 137 N. E. 611, 614.

It is important to note that Section 5219 now permits the taxation of bank dividends under a personal income tax as well as the taxation of the income of the bank itself under a corporate income tax: "A state which imposes a tax on or according to or measured by the net income of, or a franchise or excise tax on, financial, mercantile, manufacturing, and business corporations organized under its own laws or laws of other states and also imposes a tax upon the income of individuals, may include in such individual income dividends from national banking associations located within the state on condition that it also includes dividends from domestic corporations and may likewise include dividends from national banking associations located without the state on condition that it also includes dividends from foreign corporations, but at no higher rate than is imposed on dividends from such other corporations."

<sup>58</sup> See Note (1923) 8 CORNELL L. Q. 279.

<sup>59</sup> *Supra* n. 24.

<sup>60</sup> *Supervisors of Albany County v. Stanley* (1882) 105 U. S. 305.

<sup>61</sup> (1913) 231 U. S. 373, 34 Sup. Ct. 114.

standing shares) and which left out of consideration other elements such as good will and the like which enter into the determination of the actual market value of such shares. Other personal property, including capital of individual bankers, was taxed directly upon its full value, which presumably meant market value, at a higher rate than that imposed upon national bank shares. From this value, however, the taxpayer was permitted to deduct personal debts. These deductions were not allowed owners of national bank shares, and it was therefore contended, upon the authority of *People v. Weaver*, that national bank shares were discriminated against in violation of Section 5219. The court pointed out the difference in method of taxing bank shares and other personal property as a basis of distinguishing the law in question from the one in the *Weaver* case. In view of the different basis of taxation it was held that allowing deduction of debts from the value of other property was unlikely to discriminate against national bank shares<sup>62</sup> but "as against the owner of bank shares, who, by alleging discrimination assumes the burden of proving it, and who fails to show that the method of valuation is unfavorable to him, it may be assumed to be advantageous." It was further held that Section 5219 deals with shareholders as a class and not as individuals so that if the tax is fair to the class the fact that an owner of national bank stock, who is indebted, may sustain a heavier tax than another, likewise indebted, who has invested his money otherwise, will not render the tax invalid. The language of Section 5219 "clearly prohibits discrimination against shareholders in national banks and in favor of the shareholders of competing institutions, but it does not require that the scheme of taxation shall be so arranged that the burden shall fall upon each and every shareholder alike, without distinction arising from circumstances personal to the individual."

Although the state requires the valuation at its true cash value of all moneyed capital, including shares of national banks, the systematic and intentional under-valuation of all other moneyed capital, by the taxing officers, far below its true value while national banks are assessed at full value, is a violation of Section 5219. In *Pelton v. Commercial National Bank of Cleveland*,<sup>63</sup> the county auditor, a member of the

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<sup>62</sup> "With respect to individual bankers, there is a difference, they being apparently subject to the local rate of taxation and entitled to the privilege of deduction for personal debts; but as they are taxable upon the amount of the capital invested in the banking business which is normally only such as remains after the deduction of debts, it is not plain that they possess any valuable privilege of reducing the tax assessment by deducting debts." 231 U. S. 373, 392, 34 Sup. Ct. 114, 121.

<sup>63</sup> (1880) 101 U. S. 143. See also *Cummings v. Merchants Nat. Bank of Toledo* (1880) 101 U. S. 153; *Whitbeck v. Mercantile Nat. Bank* (1888) 127 U. S. 193,

Board of County Equalization, testified that the valuation placed upon the shares of national banks was higher in proportion than the valuation of other personal property, including banking capital. He stated that the matter was talked over in the board and that it was their aim to make it higher and that the value placed by them on national bank shares was intentionally higher than the assessed value returned by private banks. The court held void the discriminatory excess by the board as "this discrimination was neither an accident nor a mistake nor a rule applied only to this Bank . . . it was a principle deliberately adopted to govern their action in the valuation of all the shares of national banks and applied to them all without exception."

*First National Bank v. County of Chehalis*<sup>64</sup> is the most liberal of all the court's decisions sustaining a state's tax upon national bank shares. The bank sought to enjoin the collection of a county tax upon the shares of its capital stock, alleging that the tax violated Section 5219 for the following reasons: (1) there was exempt in the county, loans and securities due to residents of the county from residents of the county "of vast amount, to wit, exceeding the sum of two hundred and thirty-seven thousand four hundred dollars"; (2) there was exempt in the state outside of the county, \$14,000,000 in loans and securities due from residents to residents; (3) at least \$26,000,000 of stocks and bonds of insurance, wharf and gas companies were exempt, while the total capitalization of all national banks in the state was only \$7,000,000. These allegations were admitted by demurrer to the bill which was sustained by the court on the ground that the capital in question was not proved to be of a kind that comes into competition with national banks. With regard to the second and third allegations, the court has ample authority to support it but it seems that the first allegation made a prima facie case of illegation discrimination clearly within the reasoning of the *Mercantile Bank* case, and that a demurrer to such an allegation would not be sustained today.<sup>65</sup>

Owners of national bank shares have complained that state taxing laws discriminate against their shares when no provision is made for deducting investments of the bank in United States securities in arriving at the value of the shares, although such deductions are made in determining the value of assets of private bankers and individual citizens for taxation purposes. In the recent case of *Des Moines National Bank v. Fairweather*,<sup>66</sup> the United States Supreme Court upheld an

8 Sup. Ct. 1121; *Covington v. First Nat. Bank of Covington* (1905) 198 U. S. 100, 25 Sup. Ct. 562.

<sup>64</sup> (1897) 166 U. S. 440, 17 Sup. Ct. 629.

<sup>65</sup> See *First Nat. Bank v. Richmond*, *supra* n. 1; *First Nat. Bank v. Anderson*, *supra* n. 1.

<sup>66</sup> (1923) 263 U. S. 103, 44 Sup. Ct. 23.

Iowa tax upon national bank shares, although no deduction was made of the value of national securities from the taxable value of the shares. Shares of stock in national and state banks were taxed in the same manner but a deduction of the value of federal securities was made from the value of the assets of private bankers who were taxed upon their banking capital. Plaintiff bank contended that the tax was void (1) as a tax upon exempt securities; and (2) because the failure to make provision for deduction of national securities discriminated against national banks. The court held, however, that the tax upon the bank stock was not a tax upon tax exempt securities, even though the value of the stock was largely dependent upon the value of the securities. The decision on this point was placed upon the theory that the bank and the shareholders were separate and distinct entities, the securities being strictly the property of the bank and in no sense that of the shareholders.<sup>67</sup> The court has repeatedly held that as the tax is simply on the shares it makes no difference how the bank's capital is invested.<sup>68</sup> For example, the state is not required to make deductions from the value of the shares because of real estate owned by the bank outside of the taxing state;<sup>69</sup> and although the bank's real property in the state may be taxed by express permission of Section 5219, its value need not be deducted from the assessed value of the shares when they are taxed.<sup>70</sup> The court in the *Fairweather* case answered the plaintiff's contention that national bank shares were being taxed at a greater rate than other moneyed capital by stating that the exemption allowed private bankers was merely in recognition of, and obedience to, another law of the federal government that United States securities in the hands of individuals cannot be taxed by the states. The discrimination was

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<sup>67</sup> For the same reason tax exempt securities need not be deducted from the value of state bank shares when they are taxed. *People v. Commissioners* (1866) 71 U. S. (4 Wall.) 244, 258.

<sup>68</sup> *Cleveland Trust Co. v. Lander* (1902) 184 U. S. 111, 22 Sup. Ct. 394; *Home Savings Bank v. Des Moines* (1907) 205 U. S. 503, 27 Sup. Ct. 571. In *Home Savings Bank v. Des Moines*, the court declared that Van Allen v. Assessors has "settled the law that a tax upon the owners of shares of stock . . . is not a tax upon United States securities which the corporation owns." It was also asserted in the same case, "But the distinction between a tax upon shareholders and one on the corporate property, although established over dissent, has come to be inextricably mingled with all taxing systems and cannot be disregarded without bringing them into confusion which would be little short of chaos." 205 U. S. 503, 518. See also: *National Bank v. Kentucky*, *supra* n. 55; *Palmer v. McMahon* (1890) 133 U. S. 660, 666, 10 Sup. Ct. 324; *Bank of Commerce v. Tennessee* (1896) 161 U. S. 134, 146, 16 Sup. Ct. 456; *New Orleans v. Citizens Bank* (1897) 167 U. S. 371, 402, 17 Sup. Ct. 905; *First Nat. Bank v. Hannan* (1924) 266 U. S. 638, 45 Sup. Ct. 9.

<sup>69</sup> *Bank v. Chambers* (1901) 182 U. S. 556, 561, 21 Sup. Ct. 863.

<sup>70</sup> *Amoskeag Savings Bank v. Purdy*, *supra* n. 61; *People's Nat. Bank v. Mayre* (C. C. E. D. Va. 1901) 107 Fed. 570, 579.

really imposed by the federal law. It must be admitted, however, that although the result reached is perhaps a necessary consequence of the court's adherence to the entity theory, there nevertheless was actual discrimination against national bank shareholders. Whether the corporation or the shares is the subject taxed the burden is ultimately borne by the shareholder. If private bankers can deduct the value of investments in United States securities and national bank shareholders cannot, private banking capital obviously is operating under relatively lighter burdens than competing national banking capital.

In *Montana National Bank of Billings v. Yellowstone County*,<sup>71</sup> the court, no doubt properly, refused to carry the reasoning of the *Fairweather* case to its logical conclusion. National bank shares were taxed to their full value, including the value contributed by liberty bonds and other non-taxable securities. State bank shares were not taxed. State banks, however, were directly taxed upon the value of their assets, necessarily excluding therefrom the value of tax exempt securities. It was contended on the authority of the *Fairweather* case, that since the exemption from taxation of the federal securities in the hands of the state banks was created by federal statute, the discrimination was one which the state could not avoid. The court, Mr. Justice Sutherland writing the opinion, in holding that the tax imposed an invalid discrimination against national bank shares, considered the state's view of the *Fairweather* case "entirely erroneous." The cases were distinguished as follows:

"The statutes of Iowa . . . [involved in the *Fairweather* case] . . . expressly provide that shares of stock in national banks and . . . trust companies located in the state shall be assessed to the individual stockholders; and shares of national banks and those of competing state corporations are put, for purposes of taxation, upon terms of exact equality. The provisions of the Iowa statute which was assailed related to the assessment of capital employed by *individual* bankers (p. 105); and this Court held that the restriction of § 5219 was not violated because the state, perforce, allowed a deduction of federal securities in assessing the capital of such individual bankers; that the federal law made such securities exempt and the state merely respected the exemption. P. 117. The decision in no way affects the rule (*Van Allen v. Assessors* and other cases, *supra*) that in respect of the taxation of state *corporate* banks, the shares must be taxed as they are in the case of national banks, so far as necessary to prevent discrimination, and that, in neither case, does the exemption of federal securities apply in the taxation of such shares."<sup>72</sup>

Where the state taxes national bank shares and does not tax state bank shares but taxes state bank capital, the court in effect translates

<sup>71</sup> (1928) 276 U. S. 499, 48 Sup. Ct. 331.

<sup>72</sup> 276 U. S. 499, 503.

a tax on the state bank capital into a tax upon the state bank shares.<sup>73</sup> But the condition on which the states are allowed to tax other moneyed capital by different methods from those used in taxing national bank shares is that the actual tax burden on national bank shares must not be in excess of the burden resting ultimately upon other moneyed capital. The tax in the *Billings* case did not meet this condition and was therefore invalid. Whether the court's attempt to distinguish the *Fairweather* case was successful or not, the result reached seems to be unquestionably correct, because factual discrimination was admitted. The *Fairweather* case seems to weaken the sufficiency of mere factual discrimination in this situation as a ground for invalidating a tax; but it does not for the following reasons: So far as the logic of the distinction between the cases is concerned the court's adherence to the entity theory cannot be questioned, whatever be its merits when separately considered, and once the entity theory is accepted as a premise, the cases are clearly distinguishable. Under the express provisions of Section 5219 a state can tax national bank shares and cannot tax national bank capital. And the entity theory seems to compel the conclusion that a tax on the shares is properly measured by their value regardless of the basis of that value. A tax on private bankers, on the other hand, is perforce a tax on their capital and includes perforce, an exemption of that part of the value represented by federal securities. The result is that the statute exempting federal securities plus the court's adherence to the entity theory justified, if it did not indeed compel, the discrimination by the state involved in the *Fairweather* case. When we come to the *Billings* case, however, the virtual unavoidableness of the discrimination involved in the *Fairweather* case is not present, for the state has at its command, in the situation there presented, an alternative method of taxation, *i. e.*, the state may tax both national and state banking corporations by taxing their shares, and thus avoid this discrimination completely. The reasoning of the distinction is not impeccable because the discrimination in the *Fairweather* case was not in fact absolutely unavoidable. Thus the court might, it seems, have required the state to remove the discrimination by providing that in assessing national bank shares the part of the value thereof attributable to tax exempt securities held by the bank should be deducted. This would perhaps have been impracticable; and at any rate it is clear that any flaw in the distinction between the two cases arises out of the possible incorrectness of the *Fairweather* decision, and does not affect the decision of the *Billings* case, which seems to be unimpeachable. If then, as seems to be the case, the decision of the *Billings* case is good law,

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<sup>73</sup> *Supra* n. 55.

certain consequences follow which are of a serious and far-reaching nature. The case requires the conclusion that in any state having state banks holding any considerable amount of federal securities, a tax upon the state banks cannot, if national bank shares are taxed at full value, be a tax directly upon the banks but must be upon their shares.

It has long been held that a national bank may be taxed on shares it owns in another national bank because the permission of Section 5219 to tax national bank shares is unqualified.<sup>74</sup> But a national bank cannot be taxed on shares it owns in a state bank, as that is not sanctioned by the statute and is therefore impliedly prohibited.<sup>75</sup> It was not until 1919 that the question was raised whether individual shareholders of a national bank, taxed on its shares in another national bank, were entitled to deduct from the assessed value of their shares that part thereof contributed by the national bank shares on which the bank of which they were members had already paid a tax. In *Bank of California National Association v. Richardson*,<sup>76</sup> it appeared that the Bank of California owned stock in the Mills National Bank and was taxed as a shareholder therein. The state also taxed the shareholders of the Bank of California but did not deduct from the value of the shares the value of the shares already taxed. The court held that the assessment of the shareholders of the Bank of California, on the amount already taxed the bank as a shareholder in the Mills Bank, was invalid. The reason for the decision given by the court was that in Section 5219 Congress impliedly provided that the economic interests involved could only be taxed once. In the words of Chief Justice White,

"It is undoubted that the statute from the purely legal point of view, with the object of protecting the federal corporate agencies which it created from state burdens and securing the continued existence of such

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<sup>74</sup> *Bank of Redemption v. Boston* (1888) 125 U. S. 60, 8 Sup. Ct. 772.

<sup>75</sup> It was contended in *Bank of California National Association v. Richardson*, *infra* n. 76, which also involved the validity of a tax upon the plaintiff national bank as a shareholder in a state bank, that Section 5219 requires that if all national bank shares are taxed, all state bank shares must also be taxed. If shares in a state bank held by a national bank are not taxed, although shares in a national bank are taxed, there is a discrimination against national bank shares. The court held, however, that the statute and the ruling of the court in *Bank of Redemption v. Boston*, *supra* n. 74, both in letter and spirit apply only to stock ownership by a national bank in another national bank and that therefore taxation of the bank as a shareholder in a state bank was without the scope of the statute and therefore beyond the power which it conferred. The law is well put in the words of Mr. Justice Pitney, who dissented in the *Richardson* case on another point, "The non-taxability of state bank shares in the hands of a national bank is attributable to the character of the national bank as a taxpayer, not to the quality of the state bank shares as an object of taxation." See also *First Nat. Bank v. Allbright* (1908) 208 U. S. 548, 28 Sup. Ct. 349.

<sup>76</sup> (1919) 248 U. S. 476, 39 Sup. Ct. 165.

agencies despite the changing incidents of stock ownership, treated the banking corporations and their stockholders as different. But it is also undoubted that the statute for the purpose of preserving the state power of taxation, considering the subject from the point of view of ultimate beneficial interest, treated the stock interest, that is, the stockholder, and the bank as one and subject to one taxation by the methods which it provided."<sup>77</sup>

Mr. Justice Pitney, who wrote a dissenting opinion in the Richardson case, and with whom concurred Justices Brandeis and Clarke, insisted that the legal distinction between the shareholder and the corporation, as recognized by numerous decisions of the court, should control. The dissenting opinion seems to be more in accord with the traditional law on the subject.<sup>78</sup> A shareholder who cannot deduct from his assessment the value of federal securities owned by the corporation nor deduct real estate taxes imposed upon the bank has no more right to the deduction of the value of bank shares similarly owned by the bank. In these instances it is true that, if no deduction is permitted, the economic interest of the shares will be taxed twice, but the obligation of competing debtors are also so taxed. As long as the burden on national bank shares is not discriminatory, why should bank shares be given preferential treatment not enjoyed by competing capital?<sup>79</sup> Inasmuch as Section 5219 expressly authorizes the taxation of bank shares to the holders thereof, subject to certain definite restrictions, it would seem that the enumeration of the restrictions by Congress should preclude the court from implying others.

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*(To be Concluded)*

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<sup>77</sup> 248 U. S. 476, 485, 39 Sup. Ct. 165, 167. For another instance of an apparent departure from the distinct entity theory, see *Miller v. Milwaukee* (1927) 272 U. S. 713, 47 Sup. Ct. 280, where the court held invalid an income tax exempting shareholders from taxation on dividends on which the corporation had already paid a tax. Inasmuch as the most conspicuous instance of exemption from the corporate income tax was interest from United States bonds, the income tax on the shareholder reached little else but the income from those bonds. See also *Iowa Loan and Trust Co. v. Fairweather* (S. D. Iowa, 1918) 252 Fed. 605, 608, in which the court gives the shareholders as well as the corporation the benefit of the exemption allowed owners of Liberty Loan Bonds. Note (1919) 3 MINNESOTA L. REV. 257.

<sup>78</sup> *Bank of Commerce v. New York* (1862) 67 U. S. (2 Black) 620; *Van Allen v. Assessors* (1865) 70 U. S. (3 Wall.) 573; *People v. Commissioners* (1866) 71 U. S. (4 Wall.) 244; *National Bank v. Commonwealth* (1869) 76 U. S. (9 Wall.) 353; *Farrington v. Tennessee* (1877) 95 U. S. 679; *Tennessee v. Whitworth* (1886) 117 U. S. 129, 6 Sup. Ct. 645; *Bank of Commerce v. Tennessee* (1896) 161 U. S. 134, 16 Sup. Ct. 456; *New Orleans v. Citizens Bank* (1897) 167 U. S. 371, 17 Sup. Ct. 905.

<sup>79</sup> See Thomas Reed Powell, *Indirect Encroachment on Federal Authority by the Taxing Powers of the State* (1919) 32 HARVARD L. REV. 902, 916.