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SOME ASPECTS OF INTANGIBLES TAXATION IN MICHIGAN *

Robert S. Ford †

IF any new form of taxation is adopted at the present session of the Michigan legislature, it is likely to be a low rate tax on intangible personal property. Several bills authorizing such a tax have been introduced at legislative sessions in the past, but public sentiment is probably more favorable now than at any other time. Just recently the Tax Study Commission, which was appointed last year by Governor Murphy, recommended that "appropriate legislation" be enacted for the imposition of a low rate tax on intangibles. It is the purpose in this article to analyze briefly some of the legal and administrative problems of taxing intangibles in Michigan.

I

THE GENERAL PROBLEM—BACKGROUND OF PROPOSED LEGISLATION

1. *Present Taxes on Intangibles in Michigan*

Under the constitution of this state there are two general types of taxes, namely, ad valorem and specific. The general property tax falls under the first class. The second type includes: (1) the taxes on certain types of property that have been removed from the scope of the general property tax, such as mortgages, secured debts, and the operative property of certain public utilities; and (2) the taxes on various sorts of privileges, such as the inheritance tax, which is based upon the privilege of succeeding to property through testamentary disposition or the laws of intestacy, and the corporate organization fee and annual privilege fee, which are based upon the privilege of exercising the corporate franchise.

Only two specific taxes are imposed upon intangibles as such, namely the mortgage recording tax and the tax on secured debts. The annual privilege fee on corporations is measured by the proportion of the paid-up capital and surplus that is represented by property used within the state. The great bulk of intangible personal property—stocks,

* This article is based on a special report by the writer to the Michigan Tax Study Commission. The situation in Michigan is developed more fully in a publication of the Bureau of Government entitled *The Taxation of Intangibles in Michigan.*

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bonds, bank deposits, accounts receivable, etc.—are subject to taxation under the general property tax at the same rate and in the same manner as real estate and other property. However, despite this mandate in the law, the assessment of intangibles is honored more in the breach than in the observance.

2. *The Problem of Enforcement*

It is common knowledge that intangibles generally escape assessment under the general property tax. When stocks and bonds are assessed, there is often a strong tendency to relative over-assessment as compared with real estate and other property. The evasion and non-enforcement of the tax is due largely to the inability of assessors to discover the various types of intangibles for assessment purposes and to the unwillingness of the owners of such property to report it voluntarily for taxation at general property tax rates. Undoubtedly, the level of tax rates in many jurisdictions tends to discourage voluntary reporting. For example, the annual compilation by the Michigan State Tax Commission of average tax rates for all purposes in 1936 shows that, of one hundred and sixty-two cities, there were 93 with a tax rate in excess of $30 per $1,000 of assessed valuation. In 54 cities, the average tax rate for all purposes ranged from $30 to $35 per $1,000; in 25 cities, $35 to $40 per $1,000; in 8 cities, $40 to $45; in 2 cities $45 to $50; in 3 cities, $50 to $55; and in one city the average tax was $73.74.[1] Obviously, the imposition of such rates on intangibles would be very inequitable.

The opinion of students of taxation is practically unanimous in favoring the removal of intangibles from the scope of the general property tax. For example, Leland has pointed out that "The failure of many taxpayers voluntarily to disclose the intangibles which they own is not to be traced to the moral depravity of taxpayers, but is rather to be regarded as a case of 'self help' for the correction of what to many seems to be a gross injustice."[2] Jensen has stated, "both taxpayers and tax officials generally refuse to obey the law. On the whole, this prevailing evasion probably greatly mitigates the harshness of the general property tax under the existing laws; but it is a severe condemnation of a tax system to say that it cannot be just unless certain sections of it are freely evaded."[3] Other authorities could be cited on

[1] 19 REP. MICH. STATE TAX COM. 47-48 (1935-1936). In the same year the state average tax rate was $25.57 per $1,000.

[2] LELAND, THE TAXATION OF INTANGIBLES IN KENTUCKY 19 (1929) (Bulletin of the Bureau of Business Research, University of Kentucky, Vol. 1, No. 1).

[3] JENSEN, PROPERTY TAXATION IN THE UNITED STATES 171-172 (1931).

this question, but these two statements are indicative of the general attitude.

3. *Taxation of Intangibles in Other States*

There are still seven states that attempt to tax intangibles under the general property tax.[4] However, in those states very little effort is made to enforce the tax and indeed it is doubtful if it could be enforced uniformly. The inequity of taxing intangibles in the same manner as tangible property has been recognized in a number of states and the property tax law has been revised to meet modern requirements. Six states[5] have adopted comprehensive systems of property classification[6] for taxation purposes, and six other states[7] have adopted the plan of low rate taxation of intangibles, or partial classification of property. Six states provide for a general income tax under which interest and dividends are included in gross income.[8] Four states impose a special income tax on the income from intangibles.[9] Various combinations of these four general methods are found in other states.

In the states that tax the income from intangible personal property under the general income tax, intangibles have been exempted from the general property tax. The success of this plan, particularly in New York and Wisconsin, has led some to advocate the adoption of the state income tax as the solution to the problem of taxing intangibles, and indeed this does seem to be the most satisfactory plan. However, this method is not available in a number of states where the income tax is unconstitutional; in such states a system of comprehensive or partial classification of property under the general property tax is the only alternative.

4. *Limitations Imposed by the Michigan Constitution*

Michigan is greatly in need of a modernization of its property tax law. The basic law is the act of 1893 as amended and it is far out of

[4] Illinois, Maine, Michigan, Nevada, New Jersey, Texas and Wyoming.

[5] Kentucky, Minnesota, Montana, Ohio, Virginia and West Virginia. TAX SYSTEMS OF THE WORLD, 7th ed., 96-97 (1938).

[6] Comprehensive classification denotes a comprehensive plan of classifying real and personal property for taxation at different effective rates for each class. Partial classification denotes the segregation of intangibles from property in general and the taxation at rates lower than on real estate.

[7] Connecticut, Florida, Indiana, Nebraska, Pennsylvania and Rhode Island.

[8] Delaware, Idaho, New York, North Dakota, Utah and Wisconsin.

[9] Massachusetts, New Hampshire, Oregon and Tennessee. In Massachusetts, interest and dividends are taxed under a classified personal income tax.

date in many respects. A very slight degree of classification has been achieved through resort to specific taxes; but as pointed out previously, these are applicable only to mortgages, secured debts and the corporation annual privilege fee. A low rate intangibles tax which conformed to the requirements of a specific tax could in all probability be adopted without a constitutional amendment.

Some have advocated the adoption of an income tax in Michigan, although it is quite probable that the Michigan Supreme Court would invalidate such a tax. There are a number of states in which an income tax has been held to be unconstitutional under provisions somewhat similar to those found in the Michigan constitution. In Illinois, under a constitutional provision[10] requiring that property taxes shall be levied "in proportion to the value of . . . property," the Illinois Supreme Court has held the graduated net income tax to be invalid on the ground that income is property and, therefore, must be taxed at a uniform rate.[11] On the other hand, it is possible that the Michigan Supreme Court might not invalidate a graduated income tax under the Michigan uniformity clause. This opinion has been expressed by two Attorneys General.[12] It is probably safe to say that the constitutional hazard from the uniformity clause is not very serious in this state.

However, there is another constitutional barrier which is much more serious, namely, the so-called Fifteen Mill Amendment, adopted in 1932 (article ten, section twenty-one). This amendment provides that "The total amount of taxes assessed against property for all purposes in any one year shall not exceed one and one-half per cent of the assessed valuation. . . ." This amendment might well be construed to invalidate a graduated net income tax on either of two theories. In the first place, there is a substantial body of judicial authority for the proposition that a tax imposed upon the income from property is the legal equivalent of a tax upon property itself, and therefore, if the entire fifteen mills is exacted in the form of general property taxation, no room is left for the imposition

[10] Illinois Constitution (1870), art. IX, § 1.

[11] Bachrach v. Nelson, 349 Ill. 579, 182 N. E. 909 (1932). See also Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 15 S. Ct. 673, 158 U. S. 601, 15 S. Ct. 912 (1895). Professor Lutz has criticized the opinion in the Pollock case on the ground that it involved confusion of thought in the failure to distinguish between the source and object, or subject, of taxation. He points out that the income from land is normally the source of the tax, whether this is levied on the value of the land or as an income tax on the rent. LUTZ, PUBLIC FINANCE, 3rd ed., 438-439, 476 (1936).

[12] 1 MICH. HOUSE JOURNAL (1931), p. 721 ff.; BIENNIAL REPORT OF ATTORNEY GENERAL, MICHIGAN, 1933-1934, pp. 261-268.

of a tax upon the income from such property. The Supreme Courts of Alabama, Massachusetts, and Oregon have taken this position.[13] If the Michigan Supreme Court should adopt this view, it would necessarily invalidate an income tax law in Michigan.

In the second place, in a number of jurisdictions the courts have held that income is itself property regardless of its source, and that a tax upon income is a tax upon property.[14] Since the Fifteen Mill Amendment limits the tax upon property to one and one-half per cent, it follows by this line of reasoning that any income tax law which might be enacted would have to be restricted to a levy of one and one-half per cent. Such a levy would be so small as to make the yield of the tax wholly insufficient for any practicable purposes. Professor Stason has stated that the adoption of the Fifteen Mill Amendment to the Michigan constitution changed the situation regarding the constitutionality of an income tax "from one of vague doubt to one of almost certain unconstitutionality . . . except by virtue of specific constitutional authorization."[15] In any event the danger of the invalidation of a revenue measure without such an amendment is considerable, and the hazard may well be sufficient to preclude reliance upon it without specific constitutional authorization. Thus, it seems that the only safe alternative at present is to segregate intangibles and tax them under a low-rate property tax.

II

PROPOSED BILL—1937[16]

At the regular session of the legislature in 1937 a bill was introduced for the imposition of a specific tax on intangibles which seems to meet the legal requirements for such a tax in Michigan. In general, this bill was based upon the Ohio intangibles tax, which is unique in combining a property tax measured by income from "productive invest-

[13] Eliasberg Bros. Mercantile Co. v. Grimes, 204 Ala. 492, 86 So. 56 (1920); Lilienthal Mercantile Co. v. Breslin, 204 Ala. 502, 86 So. 69 (1920); In re Opinion of the Justices, 220 Mass. 613, 108 N. E. 570 (1915); Redfield v. Fisher, 135 Ore. 180, 292 P. 813 (1930). Contra, Hattiesburg Grocery Co. v. Robertson, 126 Miss. 655, 89 So. 369 (1921); Featherstone v. Norman, 170 Ga. 370, 153 S. E. 58 (1930); Sims v. Ahrens, 167 Ark. 557, 271 S. W. 720 (1925); Ludlow-Saylor Wire Co. v. Wollbrinck, 275 Mo. 339, 205 S. W. 196 (1918).

[14] Bachrach v. Nelson, 349 Ill. 579, 182 N. E. 909 (1932); State v. Pinder, 7 Boyce (30 Del.) 416, 108 A. 43 (1919).

[15] Stason, "The Fifteen Mill Tax Amendment and Its Effect," 31 MICH. L. REV. 371 at 377 (1933).

[16] Michigan Senate Bill, No. 246, Regular Session, 1937-1938, with amendments as reported in 2 MICH. SENATE JOURNAL (1937), pp. 1344, 1395.

ments" with a low rate property tax on the "true value" of "unproductive investments" and other non-income-yielding intangibles. Although the proposed bill was defeated in 1937, it will probably serve as the basis for any similar legislation in the future, and it is believed, therefore, that an examination of its chief provisions will clarify some of the problems that may arise.

1. *Nature of the Tax*

Senate Bill 246 provided for the imposition of a specific tax upon all persons owning intangible personal property having a situs within this state. Similar to the Ohio law, intangible personal property[17] was segregated into the two broad classes of productive and unproductive investments, although there were some departures from the Ohio method in the composition and treatment of these two classes. Productive intangibles were defined to include all intangibles which yield an income during the tax year, and unproductive intangibles were defined as "all intangible personal property which has a definite face value and which yields no income during the tax year." The bill provided for the taxation of all unproductive intangibles—that is, non-income yielding property with a definite face value—and those productive intangibles having a definite face value and yielding less than two per cent thereon at the rate of one-tenth of one per cent of the face value of such property; and for the taxation of other productive intangibles—those having a definite face value and yielding more than two per cent and those having no definite face value but producing some income—at the rate of six per cent of the income yield.[18]

This rather complicated procedure was proposed as a means of avoiding any conflict with the uniformity clause of the state constitution, which requires that all property, except property subject to specific taxes, shall be assessed uniformly as to rate of tax and as to the

[17] In section 1(b) of the proposed bill, intangible personal property was defined to include "accounts receivable, moneys on hand or on deposit or in transit, interest bearing obligations for the payment of money such as bonds, certificates of indebtedness, debentures, notes and certificates of deposits, either secured or unsecured, annuities, royalties, and other claims or demands arising upon contracts, shares of stock in corporations, associations and joint stock companies, certificates of ownership in enterprises conducted for profit (not, however, including partnership agreements), equitable interests in any of the foregoing classes of intangible property, and any and all other credits and evidences of indebtedness."

[18] In Ohio the rate is two mills on unproductive investments and 5 per cent on the income from productive investments.

method of assessment.[19] The Michigan Supreme Court has stated that a property tax based on an assessment is an ad valorem tax even though it may be deemed a specific tax by the legislature.[20] Under the ad valorem tax all property is assessed at its "cash value." If intangibles were taxed on the market or cash value, the rate of tax would have to be either the general property tax rate of the taxing district in which such property had a taxable situs, or the average rate imposed on all property throughout the state as determined by the State Tax Commission. Thus, a low rate tax on the "cash value" of intangibles would probably come into conflict with the uniformity clause, and it was necessary, therefore, to base the tax on unproductive intangibles on their face value.[21] The tax on productive investments was measured by the income yield.

The chief objection to this proposed plan, and it was recognized at the time, was that no-par stock yielding no income would not be taxable. By the definition of productive and unproductive intangibles, such stock would be exempt from the tax. Furthermore, this kind of stock could not be taxed at its cash value without coming into conflict with the uniformity clause, as explained previously.

This situation might be met by imposing a specific tax of ten cents per share upon all no-par stock yielding no income. In effect, this would amount to taxing such stock as an unproductive investment at an assumed value of $100. As an alternative, a specific value might be assigned to no-par stock with the provision that it be taxable at the same rate as that stock having a definite face value. These two methods are suggested by the practice in certain states of providing special treatment for no-par stock in the imposition of a franchise or privilege

[19] Michigan Constitution (1908), art. X, § 3.

[20] Although the tax on public utilities was designated as a specific tax, "A tax based upon the assessed cash value of the property assessed is not a specific tax. It is an *ad valorem* tax, and any enactment by a legislature that it is a specific tax does not make it so." Pingree v. Auditor General, 120 Mich. 95 at 109, 78 N. W. 1025 (1899) (concurring opinion). The operative property of public utilities is assessed by the State Tax Commission at its true cash value, but the rate is the average state rate imposed on property in general. Authorization for the specific tax on public utilities is found in Art. X, § 4 of the Constitution of 1908.

[21] A previous bill for a low rate tax on intangibles—House Bill No. 566 of the regular session of 1935-1936—provided for the taxation of corporate shares at their true cash value after deducting (a) the value of all property "taxed or exempted from taxation in Michigan"; (b) all credits of the corporation which are subject to or exempted from the mortgage recording tax, and (c) the credits of the corporation taxed under the provisions of the proposed act. It seems highly probable that this bill would have been declared to be contrary to the uniformity rule, even though it was designated as a specific tax, because a low rate property tax was levied on the true cash value.

tax. The Supreme Court, in upholding the particular statutes,[22] was careful to point out that the tax was a franchise, and not a property tax. Thus, it is doubtful whether such a provision would receive judicial sanction, although the adoption of either of these methods—preferably the first—would make the proposed bill more equitable.

2. *Rates*

As mentioned previously, unproductive investments and those productive investments with a definite face value and yielding less than two per cent thereon were to be taxed at one-tenth of one per cent of the face value thereof; other productive intangibles were to be taxed at six per cent of the income therefrom. Evidently it was the intention to equalize the tax rate on productive and unproductive intangibles because the tax on a two per cent bond with a face value of $100 would be ten cents on the basis of face value and twelve cents on an income basis.

3. *Business Situs*

It was provided that the taxable situs of intangibles should be at the domicile of the owner. However, an important provision was also included for the taxation in Michigan of intangibles that were owned by a person with his domicile in another state, but which were used in business carried on within this state. This provision represents a forward step in clarifying the question of jurisdiction to tax. The Michigan Supreme Court has stated in a number of cases involving the annual corporation privilege fee that the common-law rule of domicile must be applied in determining the situs of intangibles for taxation, unless a different rule is prescribed in the statute.[23] Accordingly, the privilege fee statute was changed in 1929.[24] However, no change has been made in the general property tax statute, and as late as 1932 the Michigan Supreme Court held that the accounts receivable of a foreign corporation, which were evidences of installment sales made in Michigan, were

[22] Roberts & Schaefer Co. v. Emmerson, 271 U. S. 50, 46 S. Ct. 375 (1925); New York v. Latrobe, 279 U. S. 421, 49 S. Ct. 377 (1928); International Shoe Co. v. Shartel, 279 U. S. 429, 49 S. Ct. 380 (1928).

[23] Graham v. Township of St. Joseph, 67 Mich. 652, 35 N. W. 808 (1888); In re Pantlind Hotel Co., 232 Mich. 330, 205 N. W. 99 (1925); In re Truscon Steel Co., 246 Mich. 174, 224 N. W. 653 (1929); In re Dodge Bros., 241 Mich. 665, 217 N. W. 777 (1928).

[24] Mich. Pub. Acts (1929), No. 175; Comp. Laws (1929), § 10138; Stat. Ann. (1938), § 21.203.

not subject to the general property tax in this state.[25] In this case the court stated:

> "Confronted by this line of decisions, involving both general and privilege taxes, it would be no less than usurpation of legislative power for this court to adopt and apply the doctrine of business situs to intangible property for the purpose of taxation. . . . The court must assume that the legislature intended that the common-law rule of domiciliary situs continues to govern general taxation of property."

In addition to the business situs provision, the rule of domicile was modified to provide that "intangible personal property owned by a person domiciled in Michigan, but used in connection with a business carried on or transacted outside of this state and being taxed at the place where such business is carried on or transacted shall not be deemed to have a situs in this state.".

4. *Apportionment of Intangibles to the State*

In this bill no provision was made for the apportionment of intangibles within and without the state. An apportionment fraction was included in a bill introduced in 1935 and it was also suggested for inclusion in the 1937 bill. It is probable that some method of apportionment will receive consideration in any future legislation of this type and it seems advisable, therefore, to explain the nature of the 1935 proposal.

Section 2 of that bill provided that when an "individual, firm, association or a corporation carries on a business which gives rise to credits in other states or countries the net credits taxable under this act shall be a percentage of the total net credits of such individual, firm, association or corporation, which percentage shall be the average of the following three percentages:"

1. Percentage of total real and tangible personal property located in Michigan.
2. Percentage of total payroll, salaries, bonuses and commission earnings of officers and employees paid in Michigan.
3. Percentage of total gross dollar volume of business done in Michigan.

This method of apportionment was to be available also to nonresidents except that the deduction of bona fide indebtedness was limited

[25] Reliable Stores Corp. v. City of Detroit, 260 Mich. 2 at 5, 244 N. W. 208 (1932).

to such an amount "as will bear the same proportion to the total amount of such bona fide indebtedness as the Michigan credits having a taxable situs in Michigan bear to the total credits of such individual, firm, association or corporation." (Section 4.)

This method of fractional apportionment is essentially the same as that which is followed by the state of Massachusetts in apportioning net income of business corporations to that state for the purpose of state income taxation. It has been recommended by a special committee of the National Tax Association for general adoption by those states having a corporate net income tax.[26] In 1935, there were eight states that followed this method of apportioning corporate net income.[27]

It is doubtful, however, if such a method of apportioning intangible personal property among the states would be upheld by the courts. Most intangibles can be allocated to the state of domicile of the owner or to the state in which the property has acquired a business situs, so that resort to a fractional method would be unnecessary. In the states that use the fractional method of apportioning corporate net income, it is the usual practice to allocate specifically that part of the net income for which the situs can actually be determined, such as rents, royalties, gains from sale of capital assets, interest and dividends. The apportionment fraction is applicable only to that part of the net income of a unitary enterprise operating in several states which cannot be allocated specifically according to any of the generally accepted rules of situs. That the Supreme Court probably would not uphold the fractional apportionment of intangibles is indicated in the following statement which was made in the *Wheeling Steel Case:*

> "The tax is not on the net profits of a unitary enterprise demanding a method, not intrinsically arbitrary, of making an apportionment among different jurisdictions with respect to the processes by which the profits are earned. . . . Such a tax on net gains is distinct from an *ad valorem* property tax on the various items of property owned by the Corporation and laid according to the location of the property within the respective tax jurisdictions. Here, the tax is a property tax on the accounts receivable, as separate items of property, and these are not to be regarded as parts of the manufacturing plants where the goods sold are produced."[28]

[26] "Report of Committee on Uniformity and Reciprocity in State Taxing Legislation," 26 PROC. NAT. TAX ASSN. 259 at 262 (1933).

[27] Ford, "Corporate Net Income: Allocation for State Income Taxation," 13 TAX MAG. 658 (1935).

[28] Wheeling Steel Corp. v. Fox, 298 U. S. 193 at 212, 56 S. Ct. 773 (1936).

5. *Treatment of Corporate Shares*

The taxation of corporate stock as a productive or unproductive investment has been explained previously. However, in another section of the bill, provision was made for exemption from the tax of "intangible personal property which represents other property taxed under this act or other laws of this state and is so closely identified therewith that to impose an additional tax under this act would be unconstitutional as double taxation." This is a significant provision. It was included to avoid the possibility of the entire act being held unconstitutional in the event that the rule against double taxation which has been stated by the Michigan Supreme Court in several cases should be held applicable to the specific tax levied under this bill. The theory of these cases[29] is based upon the fact that shares of stock are merely representative of the underlying physical property and that to tax both the physical property and the shares of stock, in the same jurisdiction, is inequitable and illegal double taxation. However, the cases were decided under a tax law that imposed two *general property taxes* at the high consolidated rates, one on the stock and the other on the corporate property. Under the proposed law, two taxes would still be levied, but one of them would be a low-rate specific tax instead of a high-rate general tax. The inequity is reduced, if not eliminated, and the probabilities are that the rule against double taxation as stated in the earlier cases would not be applicable.

In the court decisions relative to the general property tax law, the rule of double taxation has been applied more completely and logically in the case of stockholdings by Michigan residents in foreign than in domestic corporations. For example, shares of stock in a foreign corporation held by Michigan residents are taxable on the full market value when all of the physical property of such corporation is located outside of Michigan,[30] and are exempted when all of the physical property is located and taxable in Michigan;[31] but if the property of a foreign corporation is located partly within and partly without the state, the Michigan shareholder is taxable on the same proportion of the valuation of his stock as the value of the corporation's physical property outside the state bears to the total value of its physical property.[32] On the other hand, in the case of domestic corporations, the practical

[29] See notes 30 to 33, infra.

[30] Bacon v. Board of State Tax Commrs., 126 Mich. 22, 85 N. W. 307 (1901).

[31] Stroh v. City of Detroit, 131 Mich. 109, 90 N. W. 1029 (1902).

[32] Thrall v. Guiney, 141 Mich. 392, 104 N. W. 646 (1905).

effect of the decisions, and particularly that in the *Kresge* case,[33] is to exempt the Michigan shareholder regardless of whether the physical property is located within or without the state.

The effect of this provision in the proposed bill, therefore, is to place foreign and domestic corporations on a parity, and probably to make all shares subject to the low rate specific tax. However, there was some objection to the bill on the grounds that it amounted virtually to the imposition of a new tax on the stock held by Michigan residents in domestic corporations.

6. *Treatment of Small Loan Companies*

The strongest objection to the bill, and the one which was primarily responsible for its defeat, came from the small loan companies. In view of this situation, it seems desirable to analyze in some detail the provisions relative to the treatment of these companies. These provisions would apply also to finance companies and to installment sales in general.

In Michigan the small loan companies are regulated under the provisions of the so-called Small Loan Act[34] which limits the size of such loans to $300 and the interest rate to three and one-half per cent per month upon the unpaid principal balance. Such an interest rate appears to be excessive, but it is all-inclusive, and no other charges may be made to pay for operating expenses or to cover delinquencies.

It would seem to be inequitable to tax the gross interest of a loan company or a company whose sales are primarily on an installment basis in the same manner as gross interest on bonds in the hands of an individual. The bill, as originally introduced into the Senate and as referred to the committee on taxation, contained no provision for special treatment of these companies. In effect, they would have been taxable on gross income. In the committee, however, three amendments were added to the bill, although they were mutually exclusive.

The first provided for what might be called a ceiling for gross interest, by providing that gross interest should not exceed an "amount equivalent to interest computed on unpaid balances of principal due on any intangibles at the rate of six per cent per annum."[35] This would be an indirect method of accomplishing the desired relief, but whether six per cent is the proper limit may be questioned as it is merely an

[33] City of Detroit v. Kresge, 200 Mich. 668, 167 N. W. 39 (1918).

[34] Mich. Pub. Acts (1921), No. 317, as amended by Pub. Acts (1925), No. 181; Comp. Laws (1929), §§ 12198-12218; Stat. Ann. (1938), §§ 23.631-23.651.

[35] S. B. 246, § 1 (f) (1).

arbitrary figure. If a ceiling is established, an investigation should be made to determine what percentage of gross interest received during the year is represented by an "amount equivalent to interest computed on unpaid balances of principal due on any intangibles at the rate of six per cent per annum." Such an investigation might reveal this figure to be eight per cent, ten per cent, or some other percentage of gross interest. As an alternative, it might be well to consider the advisability of limiting the amount of taxable interest to ten per cent, or whatever figure seemed reasonable, of the gross interest received by such companies during the year. If the ceiling is linked with the unpaid balance, the bill should specify whether such balance will be an average for the year or the amount unpaid on some particular date.

The second amendment was a provision exempting "banks . . . and other companies licensed or supervised by the commissioner of the banking department or the state banking department as provided by statute."[86] This amendment would result in the complete exemption of the small-loan companies, an effect which could not be justified. The third amendment—section 3 (a)(1)—provided that from gross interest should be deducted "that portion of gross interest equivalent to actual losses and expenses incurred or paid in connection with the carrying on of any business of lending money as authorized by statute." The tax under this method would be measured by net interest. Inasmuch as this is not a general tax on net credits, there would seem to be no reason for extending such treatment to small loan companies.

In the final choice of a method, it is essential that the taxation of small loan companies and the taxation of bank shares be considered jointly. If shares in national banks are taxed at a higher rate than loan companies, it is highly probable that the bank tax would be invalidated by the United States Supreme Court on the ground that it violated the federal statute prohibiting the taxation of national bank shares at a higher rate than is imposed on "other moneyed capital."[87]

7. *Treatment of Bank Shares*

Bank shares were treated like other intangible property and subjected to the low tax rate. If bank shares were taxed at general property

[86] Ibid., § 3 (b) (10).

[87] Rev. Stat. (1878), § 5219; 12 U. S. C. (1934), § 548 (1) (b). See Merchants' Nat. Bank v. City of Richmond, 256 U. S. 635, 41 S. Ct. 619 (1921); First Nat. Bank of Guthrie Center v. Anderson, 269 U. S. 341, 46 S. Ct. 135 (1926); First Nat. Bank of Hartford v. City of Hartford, 273 U. S. 548, 47 S. Ct. 462 (1927); Minnesota v. First Nat. Bank of St. Paul, 273 U. S. 561, 47 S. Ct. 468 (1927).

tax rates while other intangibles were taxed at a low rate, it is quite probable that the bank tax would be invalidated. It was to avoid the possibility of an adverse ruling by the Supreme Court that bank shares were subjected to the low rate intangibles tax in Florida, Ohio, West Virginia, Arizona, and Indiana. On the other hand, if the federal statute should be revised to restrict the concept of "other moneyed capital" to other banking capital, as was proposed in 1934, the only restriction would be that the tax rates on shares in national banks should not exceed the tax on state banks. Until this arrangement is actually prescribed in the federal statute, it seems advisable to follow the same practice as other states that have recently revised their tax laws to provide for the taxation of bank shares at the same rate as other intangibles.

It is doubtful, however, if the method provided in the proposed bill is adequate. Presumably, bank shares would be taxed as a productive or an unproductive investment, depending on whether the yield was greater or less than two per cent. But, if bank shares yielding more than two per cent were taxed as a productive investment at the rate of six per cent, the tax rate would be greater than that imposed on other intangibles in the unproductive class. This might be construed by the Supreme Court as being contrary to the federal statute and this would invalidate the bank tax. It would probably be necessary, therefore, to tax bank shares as an unproductive investment, as is the practice in Ohio.

8. *Distribution of Proceeds*

The method of disposing of the proceeds of the proposed intangibles tax represents one of the most controversial problems. In the bill, as introduced originally, the proceeds of the tax were to be placed in a fund for the construction of state hospitals. This would have deprived some of the localities of a considerable amount of revenue because the tax would have been in lieu of local taxes upon intangibles. This provision was revised in the committee, and the final bill provided for a sharing of the proceeds between the state and local units. One-third of the proceeds were to be retained by the state, while the other two-thirds were to be distributed among the cities and counties on the basis of population.[38]

[38] The municipalities objected to this provision in the bill. It was contended that the state should not retain any of the proceeds, over and above the expense of administration. Their contention was based upon the grounds that the property tax is primarily a local tax, that the proposed tax would be in lieu of the property tax, and

The primary motive in returning a part or all of the proceeds to the local units is to provide some compensation for the loss of local revenue resulting from the adoption of a state tax in lieu of the local tax on intangibles. However, the amount of the loss in revenue to local units cannot be determined because figures are not available in any summary form showing the segregation of the levy on tangible and intangible personal property within the various local units. Even if the loss of local revenue could be determined, it is doubtful if any formula could be devised that would provide a distribution to each locality of an amount just sufficient to offset its loss of revenue. Obviously, the selection of the method of distributing the proceeds must be more or less arbitrary, although some methods are more equitable than others.

In Wisconsin, the proceeds of the personal income tax are apportioned among the counties according to the residence of the owner or location of the property, while the proceeds of the corporate income tax are apportioned according to the location of the business or property. In New York, a more general method is followed, according to which fifty per cent of the proceeds of the personal income tax are apportioned among the counties on the basis of the assessed valuation of real estate within the counties, and one-third of the proceeds of the corporate income tax are apportioned among the counties according to the ratio of the assessed valuation of the tangible personalty of the individual corporation which is located within the county.[39] It is doubtful if either the Wisconsin or the New York plans would be acceptable in Michigan because of the probability that Wayne county would receive in excess of fifty per cent of the proceeds.

A distribution according to the ratio of assessed valuation of intangible property in each county to the total assessed valuation of intangibles in the state would probably not replace the revenue lost in some localities. For example, if County *A* had $1,000,000 of unproductive investments, which were taxed at one-tenth of one per cent, and $5,000,000 of productive investments, yielding four per cent in income and taxable at six per cent of the income, the total tax collected would be $13,000. Under the same tax rates, if County *B* had $5,000,000 of unproductive investments, and $1,000,000 of productive investments yielding four per cent, the total tax collected would be $7,400.

that the administration of the tax was vested in the tax commission merely to obtain the advantages of centralized administration.

[39] The income tax rates have been increased in recent years, but the distribution is still based on the old rates.

Despite the difference in taxes levied, the two counties would receive the same amount in the distribution of the proceeds because they had the same total assessed valuations.

As mentioned proviously, the proposed bill provided that two-thirds of the proceeds were to be distributed to the cities and counties according to the ratio of the population in the cities and counties to the population of the entire state. In order to obtain some basis of comparison, a number of computations have been made to determine the amounts that would be distributed if any one of seven different methods

Table I. Comparative Amounts Distributed Under Different Bases to County Groups—Expressed in Percentage Terms

County Groups *	*Primary School Interest Fund: Actual Distribution in 1935*	*Assessed Valuation: Real and Personal Property*	*Assessed Valuation: Real Property*	*Assessed Valuation: Personal Property*	*Personal Property Taxes Levied*	*Population*	*Retail Sales*
Forest Counties							
Upper Peninsula (9)	3.34%	1.67%	1.86%	1.46%	1.41%	2.77%	2.12%
Lower Peninsula (30)	7.83	3.54	4.31	2.42	1.96	6.22	4.77
Mineral Counties (6)	4.41	2.63	2.52	3.07	3.62	3.80	2.53
Farm Counties (18)	11.50	8.52	8.63	3.27	1.97	10.42	7.47
Farm-Urban Counties (9)	10.87	9.57	9.01	6.93	5.62	10.39	9.75
Urban Counties (11)	62.05	74.07	73.67	82.85	85.42	66.40	73.36

* Numbers in parentheses are the number of counties within the group.

were followed, namely: (1) school population; (2) total assessed valuation of real and personal property; (3) assessed valuation of real property; (4) assessed valuation of personal property; (5) taxes levied on personal property; (6) population; and (7) retail sales. To facilitate comparison, the counties were grouped into five groups, following the county group classification for Michigan that was developed by the United States Forest Service.[40] Table I shows the percentages that would be distributed to the various county groups.

It will be observed from this table that all of the county groups, except the urban counties, would receive a larger portion on the basis of school population than on any of the other bases. If the distribution

[40] HERBERT, RESOURCES AND PUBLIC FINANCES OF MICHIGAN IN RELATION TO THE FOREST TAX PROBLEM 1 and Figure 1, Appendix (1931) (Progress Report of the Forest Taxation Inquiry, U. S. Department of Agriculture, Forest Service, No. 13).

were made on the basis of personal property taxes levied, the urban counties would receive a larger amount than on any other basis, while three county groups—upper and lower forest, the farm and the farm-urban counties—would receive a smaller amount than on any other basis. All of the methods, except school population and total population, would return from seventy-four to eighty-five per cent of the total proceeds to the urban counties. While a distribution upon only one basis would be the easiest to administer, some combination of bases might be considered, such as school population and assessed valuation with each weighted at fifty per cent in the formula.

9. *Administration*

The bill provided for administration of the new tax by the State Tax Commission. This is necessary in order to achieve efficient administration, but it will not insure the success of an intangibles tax. Provision should be made for the use of those administrative devices, such as collection-at-source and information-at-source, that have been used effectively in other states in facilitating efficient administration.

Attention should be directed also to the provision in the bill relative to changes in the holdings of intangibles during the year. It was provided that if the total face value of the intangibles held by any one person should change during the year that the tax should be computed upon the "average amount held throughout the year." Although this provision is probably more equitable than the usual practice of assessing the holdings of intangibles as of some certain day, the latter is more practicable from an administrative standpoint. In Ohio, tax listing day is January 1, except for bank deposits and shares in financial institutions which are listed and taxed at the source as of a certain day in November; this day is announced each year on or before December 5.

Where the constitution apparently prohibits an income tax, as in Michigan, a low-rate property tax on intangibles is the only alternative to taxation under the general property tax. Of course a special income tax similar to that in New Hampshire might be imposed, but it would be subject to the legal restrictions of a property tax. The adoption of a low-rate tax would lead to some increase in revenue, on the basis of the experience in Ohio, and it would tend to introduce a greater degree of universality and uniformity into personal property taxation. It is generally admitted that the general property tax has become, in effect, a tax on real estate and this condition should be recognized in property tax statutes. Relatively little revenue is obtained

at present from the taxation of intangibles and the attempt to enforce the present tax on personal property simply breeds contempt for the tax.

The bill that was proposed in 1937 for the taxation of intangibles meets the requirements of the Michigan situation. The constitutional pitfalls arising out of the imposition of such a tax seem to have been carefully avoided. However, some provision should be made for the use of devices that would facilitate administration. In addition, the State Tax Commission should be required to publish rules and regulations relative to the assessment and collection of the tax.

Finally, the business situs section of this bill is significant from the standpoint of eliminating multi-state taxation of intangibles. It was provided that intangibles should be taxable at the domicile of the owner, but two important provisions were made to recognize the principle of business situs: (1) those intangibles that were owned by a person with a domicile in another state, but which were used in business carried on in this state were to be taxable in Michigan; and (2) those intangibles owned by persons domiciled in Michigan but used in business transacted in another state and taxed at the place where such business is carried on were not to be taxable in Michigan. If all states imposing a similar tax would follow this practice, it would eliminate a grossly inequitable feature of intangibles taxation.