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HOW IT ACTS ON THE FARMER.

The California Mortgage Tax,

BY

CARL C. PLEHN,

Professor of Political Science, University of California.

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The Tax Inquisitor Law in Ohio, : : : :

BY THE

Hon. E. A. ANGELL,

Late of Ohio State Tax Commission.

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MORTGAGE TAXATION.

HOW IT ACTS ON THE FARMER.

The taxation of mortgages is double taxation upon the owner of the land, and therefore unjust to him. As the matter now stands, a farmer with a farm assessed at $1,000 is required to pay the full tax on his farm; and if there is a $1,000 mortgage, the holder of it is *supposed* to pay a tax on the mortgage.* But this tax, if paid at all, is in reality paid by the owner of the land in increased interest collected from him on the mortgage, because the owner of the mortgage runs the risk of being taxed and will not lend unless he is insured by extra interest against this. This is manifestly unfair to the farmer. There is no reason why property valued at $1,000, simply because it is a farm, should by any possibility be made to pay a tax on $2,000 of value.

As a matter of fact, this attempt to collect a tax twice from the same property keeps the rate on the farmers' mortgages up to the top notch, while the town collects very little taxes on mortgages. The lender makes it an excuse for charging high interest; while he intends, if possible, to cover up the mortgage, so that it will not pay the tax. If he does not live in the same county, he will succeed in doing this.

The smaller the community where the mortgaged premises are situated, the harder it is for an individual lender to hide the mortgage. The result is that individual lenders and executors and trustees avoid lending on mortgages at all, and leave the borrower at the mercy of those who can escape taxa-

* Farms are usually assessed at about half their full value, and that is just what can be borrowed on a farm mortgage.

tion on them, such as savings banks, life insurance companies and non-residents. The owner cannot borrow anywhere else. Consequently, the former have a monopoly of the farm mortgages—even in the cities these lenders have a great advantage; for, although it is less likely to be known that an individual is lending on mortgage, all are uneasy on the tax question, which keeps the rate of interest on these loans as high as possible. The attempt to collect a double tax is, therefore, oppressive to the land-owner, while it does not profit the town, because the mortgages are either in the hands of institutions exempt from taxation, or are covered up when owned by individuals.

If an attempt to collect the double tax were abandoned and mortgages were exempted from taxation, there would result:

1. An immediate reduction in the rate of interest. Individual lenders could not make the liability to a tax, which generally he does not pay, an excuse for exacting 6 per cent. on the mortgage.

2. An immediate increase of lending on mortgage. Most trustees, executors and individuals with money to invest, although they realize that bonds and mortgages are the safest securities, are unwilling to take them, because of possible taxation. So they invest their money out of sight of the tax collector in railroad or city bonds and city mortgages that pay, perhaps, only 4½ or even 4 per cent., preferring the certainty of this return to a 6 per cent. mortgage out of which, perhaps, a 2½ per cent. tax would be taken.

3. This bringing of money into the mortgage market would relieve the land owner from the monopoly that the non-taxpayers largely have in the mortgage market and would make such competition for good mortgages that people would take them at quite as low a rate as they take railroad or city bonds.

4. The bringing of more money into the mortgage market would increase building, would increase buying and improving

on the part of people of small means, because they would feel certain of accommodation in the shape of loans, and thus it would at once increase the taxable value of the town's property.

The exemption of mortgages from taxation, besides working an immediate reduction in the rate of interest, and thus profiting the land owner would in no way diminish the revenue of the town, but on the contrary very soon increase it and permit of a reduction in the rate of taxation. It is well known that a town collects scarcely anything from the tax on mortgages, so that it would be giving up little. On the contrary, by exempting mortgages, inasmuch as the step would encourage improvements and add to the taxable value of the town, the town would gain in the taxes collected. A clear demonstration of the practical effect of the step is seen in the result of exempting bonds of cities from taxation. Take the case of the City of New York, where fifteen years ago the rate of interest on all of its bonds was 6 per cent. and 7 per cent., the full legal rate, and held up to this rate because they were not exempted from taxation, while, as a matter of fact, not 10 per cent. of them were ever caught by the tax collector and levied upon. It took great persuasion to induce the Legislature to permit the City of New York to issue bonds that were exempt from taxation, or to persuade the city to try it itself, but once tried the result has been magical. The rate of interest on its exempt bonds has gone down permanently to 3 per cent., and its bonds have been sold at 2½ per cent. The city practically collected nothing by way of tax on the old bonds, so that it has lost nothing in that respect, while it has made an immense gain in the reduction of the rate of interest at which it can borrow. The same result would inevitably follow if the tax were taken off from mortgages. The land-owners who constitute the town would lose nothing in the taxes collected, while they would gain from 1 per cent. to 2 per cent. from the reduced rate of interest at which they could borrow on mortgages, to say noth-

ing of the fact that there would be plenty of money to lend on mortgages for new buildings and for improvements where now there is very little.

The rate of interest can be effectually reduced only in this way. It is a shame that every farm mortgage should run at 6 per cent.; but you cannot stop this by enacting that 5 per cent. shall be the legal rate, and no one shall collect more. The inevitable result of this latter plan is to still further reduce the existing supply of funds to loan on farm mortgage. The savings banks announce that they will at once call in their mortgages if the rate is arbitrarily reduced; and certainly the individual lenders will be fewer in number than they now are if the rate is so reduced. Such reduction will have the very opposite effect from that contemplated by the small land owners. It will result in a call upon practically the whole of them to pay their mortgages, and a disastrous crisis in consequence, because there will be no one to make new loans. On the contrary, if the present tax on mortgages is abrogated, funds that are now invested at a low rate of interest in non-taxable securities, not as safe or as easily watched as good mortgages, will be immediately turned into the market for such investment, and competition will do what arbitrary legislation cannot—reduce the interest expenses of the small land owner.

No plainer instance of the unfortunate position in which the taxation of mortgages places the small land owner, as well as the holder of such mortgages, can be found than that of the Ulster County Savings Institution, in which a large defalcation was discovered a short time ago. More than half of its assets —to wit, $1,250,000—were invested in Ulster County mortgages which were perfectly safe. So long as they were held by a savings bank they were exempt from taxation. It was found, however, that these mortgages could not, while subject to a tax, be placed elsewhere, and it was certain that they could not be paid by the farmers. Unless the bank could be permitted to

resume, it was plain that either the depositors must go without their money, or the farmers of Ulster County who had mortgaged their farms must be put to great distress. Fortunately the bank was allowed to resume; but it has been obliged to scale down its depositors and ask them to leave their balances in the bank, because the mortgages could not be collected or sold, and there was no way of realizing on them speedily. If they had been entirely exempt from taxation, there was undoubtedly money enough in the county, in the hands of individuals and executors, for investment, to have taken up the bulk of the mortgages, and to have permitted the bank to pay every depositor that wanted his money.

We come down to the inevitable and infallible proposition, that supply and demand will control the rate of interest. The land owner should realize this, and if he seeks relief from heavy interest burdens, he should do what is necessary to attract capital to him. You cannot do it by arbitrarily cutting interest down to 5 per cent. You will simply drive away what little capital there is left now, seeking investment on mortgages. You can only do it by making mortgage loans attractive to lenders, and making capitalists strive with one another to get good mortgages, which they will do the moment the legislature enables them to place them at 4½ or 5 per cent. and pay no taxes on them. They would rather have them on these terms than the fluctuating securities which they now buy, but on which they are able to evade taxation.

Here is the arithmetic of the proposition. Farmer Jones owns a farm assessed at $1,000. It is mortgaged for $1,000. He pays a tax—say 2½ per cent.—on the assessed value of his farm, or $25. He pays 6 per cent. interest on the mortgage, or $60, a total of $85. Screw, who lends him the money, charges him 6 per cent., because, theoretically, he has to pay a tax of $25, which would leave him only $35 as the net return on his $1,000, or 3½ per cent. Practically, he says: "If I

have half-a-dozen mortgages, I can keep half of them out of sight, and will only count on a half tax, so that I need allow only $12.50 for my tax out of my interest of $60." This leaves him $47.50 net, or 4¾ per cent.

Farmer Jones may think that by making Screw pay the $25 tax on the mortgage, he can get his own tax rate reduced. But does Farmer Jones suppose that Screw will continue his loan of $1,000 at 6 per cent. and pay the tax of $25 out of it, and take 3½ per cent. for his money? Not at all. Screw would at once call his money, and so would every other lender on mortgage, and Jones would find himself perhaps ruined, if he could not pay his $1,000. Real relief will come to the farmer by the opposite course. If Screw were relieved altogether of any obligation to pay a tax on his mortgage, he would much rather lend the money at 5 per cent., or $50 per annum, than at 6 per cent., taking his chances on taxation.

No good would come to the farmer from allowing a deduction of mortgages from the assessed value of farms. The fact that a farm was mortgaged for $1,000 would be conclusive proof that it was worth *at least* $2,000, and so its assessed value would be doubled. The farmer would have to pay *more* taxes, not less, because he would then be required to pay the tax on the mortgage and take his chance (which would be very small) of getting it back from the money lender. The lender would call in the loan, and the farmer would be left assessed for all future time at $2,000 instead of $1,000.

The exemption of mortgages from taxation would bring to the farmer relief which he cannot hope to get in any other way; and with the abolition of the tax on mortgages, the competition that will follow for good mortgages will eventually still further reduce his rate of interest.

THE CALIFORNIA MORTGAGE TAX.

BY CARL C. PLEHN.

PROFESSOR OF POLITICAL SCIENCE, UNIVERSITY OF CALIFORNIA.

One of the most interesting of the many novel measures introduced in California by the Constitution of 1879, is the method prescribed for the taxation of loans secured by mortgages. In 1876 the Supreme Court decided that under the old constitution mortgages could not be taxed. The convention to frame a new constitution, which met three years later, was, in a general way, unfriendly to capital, as was natural, since Denis Kearney, with his sand-lot followers, and the Grangers played an important part in the movement which led to the calling of the convention. The intention of the members to see to it that money and the money-lender did not escape taxation, is especially obvious in that part of the new instrument which deals with revenue, and the decision just mentioned did not escape their attention. In the hope of placing the burden of taxation on the lender, and at the same time of avoiding double taxation and of protecting the borrower, it was provided that:

> "A mortgage, deed of trust, contract or other obligation by which a debt is secured, shall, for the purposes of assessment and taxation, be deemed and treated as an interest in the property affected thereby * * * the value of the property affected by such mortgage," etc., "less the value of such security, shall be assessed and taxed to the owner of the property, and the value of such security shall be assessed and taxed to the owner thereof."

Another section of the Constitution declares that every con-

tract "by which a debtor is obliged to pay any tax or assessment on money loaned," shall be null and void, and as a penalty no interest can be collected on mortgages affected by such illegal contracts.

To comprehend clearly the nature of this tax it is necessary to know its place in the tax system of the State. California depends, almost entirely, on the so-called general property-tax. Theoretically each property-owner is required to contribute toward the support of the State and local governments in proportion to the amount of property of every kind which he holds. The tax laws carry out the theory of this system with logical consistency and prescribe what is generally considered to be a model form of the general property tax. The method provided for the taxation of mortgages is strictly in accord with the theory and has on that account met the approval of many experts in taxation. But the general property tax is entirely unsuited to modern economic conditions, and even the California tax law, approximately perfect as it is, cannot be successfully administered. In the general wreck of a tax system exceptionally strong features of the law are apt to cause exceptional hardship. If by any possibility all property could be reached, as the law requires, the California system of taxing mortgages would be perfectly fair and proper. But all property is not and cannot be reached, while mortgages are. This tax is therefore regularly shifted to the debtor together with a little something more, about one-quarter of 1 per cent., to insure the lender against a possible loss by a change in the tax rate. Moreover, the tax is heavier than on other property because mortgaged property is more sharply assessed. The consequence is that borrowers have to pay, in interest and taxes together, about one-third of 1 per cent. more than they would have to pay if the entire tax were assessed to the property owner and the mortgage, as such, were exempt. Mortgaged property is more sharply assessed than other property

because a clue to its value is to be had from the record of the mortgage. Real estate in California pays nine-tenths of all taxes, and of these nine-tenths mortgages, although constituting only one-sixth as to value, pay one-fifth.

The shifting of the tax, which entirely defeats the purpose of the framers of the measure, can be seen from the following facts: The average rate of taxation throughout California, for State and local purposes together, is about 1.75 per cent. on the assessed valuation. It varies this year from 1.03 per cent. in Santa Clara County to 3.20 per cent. in Sierra County. In San Francisco it is 1.6954 per cent. The average rate of interest upon mortgages in California for the decade 1880–'89, according to the Eleventh Census, was 8.90 per cent., or exactly 2 per cent. more than the average throughout the United States, which was 6.90 per cent. At present the rate of interest has fallen here, as elsewhere in the United States; but the best evidence shows that it is still, for mortgages, at least 2 per cent. higher than the general average.

There is no reason, outside of the tax system, why the rate of interest on mortgages in California should be any higher than, or even as high as, the average for the United States as a whole. Capital has been abundant, the security is excellent, the prospect for the future of land values good, and there is less than the average demand for loans. In 1890 less than one-sixth of the real estate (by value) was encumbered, and the average percentage of such encumbrances to the value of the property affected was 43.81. These facts seem to justify the conclusion that the mortgage tax raises the rate of interest to borrowers by about 2 per cent. on the average. It is further true that the rate of interest charged on mortgage loans of the same degree of safety is greater in counties where the tax rate is regularly high than in counties where it is usually low. And, as a last bit of evidence, mortgages due, but which might be safely permitted to run for the time allowed by the

statute of limitations, are frequently called in and the rate raised to cover an increase, or even an anticipated increase, in the tax rate.

The explanation of the failure of the mortgage tax to accomplish what was expected of it is to be found in the fact that this is almost the only form in which a money investment, as such, is taxed. Few, if any other forms, can be reached. This year only $31,000,000 of "money and solvent credits" appear as part of the total assessment which amounts to $1,089,000,000. But mortgages are assessed at $177,000,000. No device has yet been found which will enable the assessor to discover the multitude of intangible forms of property which are characteristic of modern times; and whenever capital comes out of its hiding-place and shows itself in some form in which it is bound to be taxed, the man who calls it forth must pay the tax and all the other costs of such exposure.

In practice, then, the California mortgage tax sins against the fundamental principles of just taxation in two ways: 1. It brings about inequality of taxation, since mortgaged property is assessed more sharply than other property. 2. Being regularly shifted it imposes a burden on the eventual taxpayer larger than the tax actually received by the Government.

BERKELEY, CAL.

THE TAX INQUISITOR LAW IN OHIO.

BY THE HON. E. A. ANGELL,

LATE OF OHIO STATE TAX COMMISSION.

The proposition that all property of every kind should be taxed at its true value in money at a uniform rate is one which, upon its face, seems fair. In many of the States this principle of taxation is established by the fundamental law. It is expressed in the Ohio Constitution of 1851 in the following language :

"Laws shall be passed, taxing by a uniform rule, all moneys, credits, investments in bonds, stocks, joint stock companies, or otherwise; and also all real and personal property according to its true value in money."

The debates of the Constitutional Convention of 1851 show that the advocates of the general property-tax held rose-colored opinions about its efficiency; they thought our State would become a Utopia when this system was once set in operation.

It is needless to say that their dreams were not fulfilled. One of the first lessons learned by all students of taxation is the inevitable breakdown of the general property-tax whenever it is tried. The attempt has been made for hundreds of years. The tax has been abandoned everywhere else in the known world except in the United States and in Switzerland.

In Ohio, however, for twelve years past an attempt has been made to render it effective. The stringent requirements of the Ohio listing law, which compels every one, under a penalty of 50 per cent., to return under oath for taxation all of his property, have been supplemented by a system of paid informers.

The system really dates from 1885, although a curious act was passed in 1880, applicable only to Hamilton County, in which Cincinnati is located. By the act of 1885 the county officers of Hamilton and Cuyahoga Counties (Cleveland is in Cuyahoga County), were authorized to employ any person to ascertain and furnish to the County Auditor the facts and evidence necessary to authorize him to subject to taxation any property improperly omitted from the tax duplicate; payment for these services was to be made only out of the money actually paid in as taxes on the omitted property. Three years after this another act was passed applicable generally throughout the State. It was, however, provided by this act that the compensation should be limited to 20 per cent., and the field of inquiry was limited to "omitted moneys, credits, investments in bonds, stocks, joint stock, annuities or other valuable interests."

Let us now see what the operation of these laws has resulted in. Confessedly, the energies of the tax inquisitor are limited in stocks and bonds. It has been asserted by the advocates of the law that it results in inducing large returns of personal property for taxation. If the law is a success in this respect it will appear in the returns of intangible property (moneys, credits and stocks and bonds), in Cleveland and in Cincinnati.

Let us compare the returns of intangible property in Hamilton County thirty years ago with the corresponding returns at the present time:

1866	$17,460,477 00
1867	17,199,669 00
1868	15,455,611 00

The corresponding figures for the present time are as follows:

1894	$5,722,789 00
1895	6,036,935 00
1896	5,389,350 00

The amount of money returned in Hamilton County in 1866 was $6,778,883, while in 1896 it was $1,097,283. The amount of money on deposit in Cleveland banks in 1896 is about $70,000,000, and of this there was returned for taxation in 1896 $1,741,129. It must be borne in mind that the population and wealth of these cities have marvelously increased within this period. Cincinnati was a city of about 160,000 in 1860; it has now more than 400,000. Its growth in wealth is more striking than the growth in population. So, too, of Cleveland. Any discussion would be inadequate which did not take these facts into consideration. There are on deposit in the banks throughout the State about $190,000,000; of this $135,000,000 or $140,000,000 are in the five city counties. These city counties return for taxation about $5,000,000 in money, while the remainder of the State returns $29,000,000 out of perhaps $60,000,000. So of credits and stocks and bonds. The whole amount of stocks and bonds returned in the whole State is but $7,000,000. Thirty years ago it was over $12,000,000. It is evident at once, therefore, that the informer scheme does not make the general property tax effective. It has utterly broken down in Ohio as elsewhere. The merest bagatelle is reached outside of visible tangible property.

What else has been accomplished? We do not know the amount collected in the State at large by the operation of these laws prior to 1893. Since that date the figures are attainable. We do know the amount collected under this law in Hamilton and Cuyahoga Counties since 1885. In Hamilton County $705,067.30 has been collected, and in Cuyahoga County $891,239.99 has been collected. Of these amounts 25 per cent. has been paid to the inquisitor and 4 per cent. to the County Auditor, a total of about $462,929. The amount net to the two counties is $1,133,378. Under the system of taxation in Ohio the amount which goes to the State Treasury is about 7

per cent. It is a matter, therefore, of local interest mainly. The indirect results of the operation of the law have been to drive away large masses of capital from the State. It is estimated that at least $200,000,000 has been lost to Cleveland alone, and as much more to Cincinnati. Another well-established result has been the unparalleled depreciation of real estate in Ohio. Real estate in Cleveland is much lower than in any other city on the Great Lakes. The reason is obvious. Let one hundred men of large wealth be driven from a city and the possible buyers of high-priced real estate are limited in number. This depreciation has been most marked in high-class residence property. Twenty to twenty-five years ago land in the residence part of Euclid Avenue had a ready sale at $400 to $500 a foot front; it is not worth half that sum to-day. The reason is an obvious one when it is recalled that the people who formerly bought such property now live in Washington and New York.

The moral aspects of this question are, however, the important ones. It should be remarked that neither of the act of 1885 nor of 1888 provides any of the safeguards which are commonly thrown around the making of contracts by public officials. There is no provision for the advertising for bids, nor that the contract should be let to the lowest bidder; there is no provision for publicity in the making of these contracts. In the Act of 1885 there is no restriction whatever placed upon the rate of compensation to be paid to the tax inquisitor; this rate is absolutely unlimited. In the Act of 1888, which applies to the rest of the State, it is restricted, as we have seen, to 20 per cent. There is no limit whatever in either of these acts to the length of time for which these contracts can be made; the term has generally been three years; but it might be twenty years so far as any limitation is fixed by the act. Again, the County Auditor in all these cases sits to hear evidence, to consider and determine; yet he receives a large fee if

he decides one way, and nothing if his decision is the other way. If the "case" involves $200,000 (which is no uncommon thing) he receives $8,000, and the inquisitor, $50,000. Many cases have been brought in our courts in which the amount demanded by the State against the citizen has varied from $50,000 to $250,000. One case is reported (Myers v. Shields, 61 F. R., 713), in which the amount demanded was $192,000. In the practical administration of the law the County Auditor is dominated entirely by the controlling will of the inquisitor. It is the latter that negotiates all the settlements. Suits are brought for fabulous sums of money, conducted by private counsel employed by the informer and settled for the merest bagatelle of the amount demanded.

We have, therefore, all the elements and all the opportunities of great corruption. Stories are whispered about of large sums of money paid, no part of which ever reaches the County Treasury. Be this as it may, one thing is certain. It is not right that a State should place such temptation in the way of its public officials. It is not consistent with the spirit of our liberties that men should be commissioned in the name of the State to worm into the private affairs of its citizens. To men who inherit the traditions of English liberty the trade of an informer has always been a hateful one. We have sought as a race by the constitutional enactments which date back certainly as far as *Magna Charta* itself, to protect ourselves from this kind of intrusiveness.

CLEVELAND, O.