

1878

A NEW METHOD FOR THE TAXATION OF PUBLIC SERVICE CORPORATIONS.

Proposed by Lawson Purdy, Secretary New York Tax
Reform Association.

The property and business of public service corporations should be taxed as a unit by a mathematical rule that will eliminate the necessity for the exercise of judicial discretion by the assessors.

This proposition seems to me so self-evident that I am in some doubt, within the limits of a short essay, how to present the arguments in its favor.

In most of the American states the taxation of railroads and other public service corporations had its beginning in the general property tax. This was soon found defective, and in some states has been abandoned altogether, in others supplemented by new forms of taxation, while in a few states at least railroads were never subjected to the general property tax, but were taxed from the beginning by special systems devised for the purpose.

State Railroad Commissioners Condemn General Property Tax.

In 1878 the convention of state railroad commissioners appointed a special committee consisting of Charles Francis Adams of Massachusetts, W. B. Wil-

Williams of Michigan and J. H. Oberly of Illinois to examine and report as to the methods of taxation as respects railroads and railroad securities then in vogue in the various states of the Union, as well as in the various countries, and to report a plan for an equitable and uniform system for such taxation. These commissioners issued a circular and interrogatories in relation to the matter, which was sent to all the state executives, to a large number of railroad corporations and to a number of foreign countries. The replies are printed in full as part of the report of the committee, and a compendium of the systems in use in all the states of the Union was prepared. In their report the committee said: "The conclusions reached by the committee as a result of their investigations can be very briefly stated. The requisites of a correct system of railroad as of other taxation are that it should, so far as it is possible, be simple, fixed, proportionate, easily ascertainable and susceptible of ready levy. * * * The conclusion at which your committee arrived was that all the requisites of a sound system were found in taxes on real property and on gross receipts, and in no others." The committee proposed that the real estate outside of the right of way should be locally assessed exactly in the same way as other real estate. Beyond that a certain fixed percentage should be assessed on the entire earnings of the corporation, and this should be in lieu of all forms of taxation upon the property of the corporation and upon its securities. The entire burden should be imposed in one lump on the corporation, and levied directly. The committee-

proposed that when a railroad is only in part in one state the tax should be apportioned in proportion to mileage.

The committee discussed various forms of taxation and condemned the law of Massachusetts as it then was and said: "Clumsy and devoid of scientific merit, as it unquestionably is, however, the Massachusetts system would seem to be preferable to that still in use in New York, concerning which the state assessors, in their annual report for 1873, expressed the opinion that under it there was 'no uniform rule for any road in any county, each assessor being governed entirely by his own views.' In certain towns the railroads appear to pay about one-third of the entire taxes, while the assessed valuation in 1878 varied from \$400 per mile to \$100 per rod. The 'difference in the assessment of the New York Central and Hudson River road, where for all purposes that the road can be used it is of the same value to the company, is \$24,000 per mile. In short, it is scarcely an exaggeration to say that the assessments are as unlike as the complexion, temperament and disposition of the assessors.' It does not need to be pointed out that a system such as this, and it is the system in most general use, compels the corporations in self-defense to an active participation in local politics. Indeed, it is not too much to say that as a system it is open to almost every conceivable objection."

The New York system, which is so severely condemned, remains unchanged to this day, though supplemented by other taxes. One railroad in the state of

New York, which has by no means the largest mileage, pays more than 1,900 separate tax bills every year, and all the railroads have constant trouble with local assessments and are obliged to keep track of an enormous number. This is an obvious waste of effort and source of demoralization.

Gross Earnings Tax Unjust.

Professor Edwin R. A. Seligman, in his work on "The Taxation of Corporations," speaks of the inadequacy and practical failure of the general property tax. He speaks of the general property tax as applied to railroad and other public service corporations as primitive, unequal and as furnishing an incentive to dishonesty. The only system now in use in any American state which he commends is that employed in Connecticut, that is, measuring the tax by the market value of the stock plus the indebtedness in the proportion that the mileage in the state bears to the total mileage, the assessment of course being made by one single board. Professor Seligman makes a very strong and I think conclusive argument against the gross earnings tax as economically unsound and legally invalid. He speaks of the report of the Railroad Tax Commission, from which I have already quoted, with much respect, but says of the gross earnings tax which they recommended, that while it possesses many undeniable advantages, it has a fatal defect. "It is not proportional to the real earning capacity, it takes no account of cost, nor does it pay any

regard to the expenses which may be necessary and just. * * * Of two corporations which have equally large gross receipts, one may be in a naturally disadvantageous position which increases unduly the cost of operation or management. Clearly its ability to pay is less than that of the rival company in possession of natural advantages." Mr. Seligman argues in favor of a net receipts tax, but recognizes that there are certain dangers connected with this plan.

A New Method Proposed for the Taxation of Public Service Corporations.

I think all the objections that can be raised against the net receipts tax can be obviated by imposing the tax in a similar manner to the United States internal revenue law of 1864. The tax was imposed on all dividends and all interest. In framing such a law for the use of any state it would be necessary to use all dividends and interest simply as a measure of the tax. The tax could not be imposed directly upon the dividends and the interest, or we should meet the same difficulty as that experienced by Pennsylvania in its attempt to tax foreign held bonds. This difficulty is entirely met by using the dividends and interest paid on indebtedness simply as the measure of the tax upon the corporate property within the state. For the purpose of illustration I have made a computation from the data contained in the report of the New York Railroad Commission, and I find that the total taxes of all kinds paid in all states by the steam surface railroads reporting to the railroad commission in

the state of New York amount to slightly less than 15 per cent of the total disbursements of these roads on account of interest and dividends. When the property of a railroad or other public service corporation is situated in more than one state, the tax must be apportioned on the mileage basis now in common use.

The real estate owned by public service corporations, when not used in the operation of the public service, should be subject to local taxation by the same method and to the same extent as other real estate. The revenue derived from taxing the corporate property as a unit should be distributed to the tax districts in which the corporation carries on its public service in proportion to the length of its tracks, including branches, sidings and switches within those districts.

Let us briefly consider some of the advantages of this manner of taxing all public service corporations.

If the tax on all the corporate property is measured by the dividends and interest paid, the corporation has only one assessing board to deal with, and that assessing board has purely ministerial functions to perform. It ascertains the amount of interest and dividends paid, a matter which cannot be concealed, and performs a simple sum in multiplication. The corporation knows exactly what tax it will be obliged to pay, it has no interest in the personnel of the board that does the assessing, because no dispute can arise as to the amount of the tax.

When a new corporation starts its tax will be light. If it earns neither interest nor dividends it will pay

no tax at all, and should not, because it is rendering a public service at cost. If it earns interest and dividends for those who contributed the capital, in proportion as it pays them it must pay taxes to the state. In prosperous years its tax will rise and in lean years it will fall automatically.

It may be objected that if a railroad or other public service corporation becomes bankrupt no tax will be paid upon its property, but this is an advantage, not a disadvantage, for it is for the public interest that a corporation in such condition should be rehabilitated as soon as possible, and the automatic cessation of taxation will operate to that end. As soon as it earns more than the cost of the service it renders it will again be taxed. It may be objected that a corporation could refrain from paying dividends and accumulate a large surplus. This, again, is rather an advantage than an objection, for in the long run its accumulated surplus will enable it to perform better service, pay larger dividends, and in consequence heavier taxes.

From every point of view and in accordance with the testimony of all experienced observers, with whose writings I am familiar, it is clear that all public service corporations should be taxed as a unit, and it seems self-evident that discretion upon the part of assessors should, if possible, be eliminated. I have suggested a method already tried and found effective, by which the assessment can be made without judicial discretion.

Street, New York.

New York, June 29, 1905.

My Dear Sir:—I have read with great interest the proposition No. 4 of the Public Policy Taxation Platform, together with your discussion. It gives me great pleasure to say that I thoroughly approve of the proposition and of the reasons that you so cogently advance in its support. Sooner or later the logic of events will compel the adoption of this scheme or of some scheme on a similar line. The plan that you outline is simple, just and effective.

With kind regards,

Yours sincerely,

(Signed) EDWIN R. A. SELIGMAN.

Office of the President, The Delaware & Hudson
Company, 21 Cortlandt Street, New York.

New York, June 28, 1905.

Dear Sir:—I have read Mr. Purdy's suggestion with reference to taxation of corporations and write to say that it seems to me to be sound. As I said when you were here, I have already discussed the subject with Mr. Purdy, and I think it the best suggestion which I have seen upon the subject.

Yours very truly,

(Signed) DAVID WILLCOX.