THE TAXATION OF INSURANCE COMPANIES, BANKS, AND BUILDING AND LOAN ASSOCIATIONS IN MICHIGAN

Thesis for the Degree of Ph. D.

MICHIGAN STATE COLLEGE

Arthur M. Taylor

1954

This is to certify that the

thesis entitled

The Taxation of Insurance Companies, Banks,
and Building and Loan Associations in Michigan

presented by

Arthur Merle Taylor

has been accepted towards fulfillment
of the requirements for

Ph.D. degree in Economics

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O-169

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THE TAXATION OF INSURANCE COMPANIES, BANKS, AND BUILDING AND LOAN ASSOCIATIONS IN MICHIGAN

By

Arthur M. Taylor

AN ABSTRACT

Submitted to the School of Graduate Studies of
Michigan State College of Agriculture and Applied Science
in partial fulfillment of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

Department of Economics

Year 1954

Approved Denzel C. Cline

9-27-54
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ABSTRACT

From 1949 to 1953 the General Fund of the State of Michigan incurred a mounting cumulative deficit. The result was the enactment of more than six new tax measures in 1952 and 1953. The focus of attention has been and will continue to be to an important degree upon financial institutions because of their vast resources. The purpose of this inquiry is to evaluate the present tax system and propose alternative courses of action to attain desired tax policy objectives.

The procedure followed was to study the literature in the field of state finance and, on the basis of the findings, to set forth the premise that the Michigan tax system for insurance companies, banks, and building and loan associations is inequitable and inefficient. Further research was conducted by obtaining personal interviews with tax officials, studying the files of administrative agencies and analyzing compiled tax agency reports.

It was found that financial institutions enjoy special tax privileges not extended to other types of businesses; that inequities exist between the tax burdens on banks, insurance companies and building and loan associations and; that the problem of administering this tax system is complicated by the number of tax bases and rates, the number of administrative agencies and the frequency of exemptions.

It is the hypothesis of this study that these deficiencies may be overcome by levying a franchise net income tax in lieu of certain existing taxes, the rate to be equalized between types of businesses and the revenue collected by one central agency. The general characteristics of such a plan are presented in the final chapter.

An alternate proposal for reducing inefficiencies and inequities is also outlined. This proposal would introduce no taxes with which the state has had no experience but is based on revising and extending existing tax statutes.

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CHAPTER I

INTRODUCTION

Problem of the Thesis

The Michigan tax system is an extremely complex machine. It has grown because of the need for revenue. The way it has grown and the shape it has assumed have been determined to a large measure by restrictions imposed by the state constitution and federal regulation.

Primarily, the state legislature is bound by the constitution to "provide by law for an annual tax sufficient with other sources to pay the estimated expenses of the state government, the interest of any state debt and such deficiency as may occur in the resources."[1]

In the 33 years from 1920 through 1952 the system of financing government in Michigan has undergone many significant changes. Total annual disbursements of the state government (excluding Federal aid) have risen from $35 million in 1920 to $593 million in 1952, indicating a net increase of $558 million.[2] This represents the cost of state government to the Michigan taxpayer.[3] The factors responsible

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[1]Michigan Constitution, 1908, Art. X, Sec. 2.

[2]Annual Reports, Auditor General, State of Michigan, Lansing, Franklin DeKleine Co., 1920-1952.

[3]Cost of government includes state aid.

for this increase include the greater social responsibilities of the state because of urbanization and industrialization, the rise in the general price level, and the economic and social changes brought about by the depression of the 1930's and World War II.

To finance this higher level of expenditures, total receipts of the state (excluding Federal aid) have increased from $47 million in 1920 to $565 million in 1952, a net increase of $518 million. From 1940 to 1947 operating revenue each year exceeded expenditures and this resulted in an accumulated surplus of $108 million in the funds of the state. However, in 1948 the trend was reversed and for the next four years expenditures exceeded operating revenues and the balance of expenditures over receipts was provided out of the reserves accumulated in previous years.

Although accounting reports for fiscal year ending 1951 indicate a balance of $82 million for all funds further investigation indicates (1) these funds were committed for special purposes by legislative action, and (2) the General Fund was overdrawn by approximately $41 million. By June 1952 the accumulated deficit had grown to $65 million. The Auditor General's financial report for fiscal year ended June 30, 1952 has this to say:

> "During the first three years of the pyramiding of these General Fund deficits, a sizeable but dwindling cash balance enabled the State to continue its operations. In 1951 to 1952, however, the depletion of cash balance has from time to

> time caused delays in payment. Operations in the coming year will be seriously impaired unless steps are taken to return the budget to balance. THE RE-ESTABLISHMENT OF SOUND FISCAL POLICIES IS NOT ONLY EXPEDIENT, IT IS IMPERATIVE."

To understand the complex system of Michigan state finance it is necessary to have a clear concept of the nature of the General Fund. There are seven state operating funds of which the General Fund and the Highway Fund are by far the largest. As indicated in the preceding paragraph not all of the annual payments from the General Fund are "appropriated" for expenditure (budget items) because there are many restricted accounts within the General Fund. Since the earmarked or restricted accounts within this fund enjoy their own independent sources of income, actual budget cuts fall heavily upon the relatively small portion of the General Fund which goes for operation and capital outlay.

There are two types of deficits or surpluses to be distinguished: operating and cumulative. Operating deficits are those incurred when expenditures exceed revenues in any one fiscal period. An operating deficit may or may not result in a cumulative deficit depending on whether the fund has any surpluses carried over from the previous year, and the size of such surpluses. This is illustrated in Table 1.

During the last twenty years General Fund balances have gone through three stages. First, there was the depression period during which heavy deficits were incurred.

The second period was one of prosperity beginning in

TABLE 1

GENERAL FUND (IN MILLIONS OF DOLLARS)[1]

	Expenditures	Revenues	Operating Surplus (def)	Cumulative Net Surplus (def)[2]	
1939-40	117	103	(14)	(28)	
1940-41	130	154	24	(18)	
1941-42	145	171	26	7	
1942-43	152	182	30	28	($50 million
1943-44	164	188	24	14	set aside in
1944-45	174	202	28	13	Veteran's
1945-46	223	244	21	22	Benefit Trust
1946-47	285	289	4	23	Fund)
1947-48	364	363	11	34	
1948-49	407	393	(9)	24	
1949-50	443	402	(46)	(21)	
1950-51	477	460	(19)	(41)	
1951-52	505	494	(24)	(65)	
1952-53	544	578	34	(31)	

[1]Unpublished report, State of Michigan, Office of the Comptroller, July, 1950. Figures 1948-53 from Financial Report of the State of Michigan, fiscal year ended June 30, 1953, Part I, p. 15.

[2]Reflects net effect of changes in reserves of prior years, and establishment of $50 million Veteran's Benefit (Trust) Fund.

fiscal year 1941. Revenues exceeded expenditures for several years resulting in the replacement of the cumulative deficit with a cumulative surplus. In 1943-45, $50 million of this surplus was set aside in a Veteran's Benefit Trust Fund.

The post war period constitutes the third stage. This was a period of state deficit financing in which the level of expenditures continued to rise at a rapid rate while the level of revenues began to level off. From 1949 to 1953 expenditures exceeded revenues each year. Accounting figures indicate an actual deficit of $65 million in 1952.[1]

This trend in state finances precipitated the search for new revenue sources and the agitation for tighter administration of existing sources. At least six acts of legislation were adopted in 1952 and 1953 raising tax rates and creating new taxes. Additional emergency steps were taken in 1953 to halt the deficit trend and provide operating revenue. First, the corporate franchise tax collection date was changed from August to May, thereby providing that the tax be collected twice in fiscal year 1953. Second, expenditures were reduced $6.5 million by the expedient of using Veteran's Military Pay funds to apply on bond and interest payments.

The result of these combined actions was that the state concluded the fiscal year 1953 with a General Fund operating surplus of $34 million. The accumulated General Fund deficit

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[1]See Table 1.

was thus reduced from $65 million in 1952 to $31 million in 1953 (see Table 1).

The advance collection of the corporation franchise tax and the use of Veteran's Military Pay funds were of course recognized to be non-recurring items and the legislature enacted an important new "business activities tax" to maintain a high revenue level in 1954. This law expires in 1955. The Michigan Department of Revenue concludes in its annual report for fiscal year ended June 30, 1953 that ".. it appears that to date there has been no final or definite solution to Michigan's "financial crisis", and future developments will determine the General Fund balances in 1955 and thereafter."[1]

This critical need for state revenue has brought attention to bear upon the vast resources of financial institutions and the possible preferential tax treatment tendered them in the past. It is therefore expedient that a careful study be made of the manner and extent to which financial businesses should be taxed. From both the taxpayer's and administrator's point of view this reopening of the controversial tax issues affords an opportunity for rectifying any inequalities in the existing system.

A preliminary survey by the writer indicated that a

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[1] p. 1.

revision of the Michigan tax system affecting financial institutions was in order. It was found that:

1. In 1945 insurance company state and local taxes were 5.5 percent of net income across the country. Banks paid 11 percent. In contrast trade associations paid 16.6 percent and manufacturing concerns paid 27.1 percent.

2. Due to tax exemptions and low rates Michigan financial institutions appeared to carry a lighter tax burden than the average of similar institutions in other states.

3. Of the six major taxes relating to financial institutions in Michigan none are uniformly applicable to banks, building and loan associations and insurance companies. Five separate agencies are involved in administering these taxes.

4. Of the same six taxes only one is based on percentage of net income and then only partially so. Other bases include gross receipts, capital and surplus, and assessed valuation of tangible property.

Because of the pressure for new state revenues and the suspicion that financial institutions are receiving favorable tax treatment, it is important that study and recommendations be made relating to the taxation of insurance companies, banks and building and loan associations prior to the enactment of further legislation.

Premises

As a result of the findings enumerated above, the following premises are set forth:

1. Inequities of tax burden exist between financial institutions of various types within the Michigan tax system.

2. The taxation of financial institutions bears no relation to capacity-to-pay as measured by net income.

3. The administration of taxes for financial institutions is complex and inefficient.

Tentative Hypothesis

This study attempts to prove that a comprehensive revision of the present tax system for financial institutions incorporating taxes measured by net income, equalized between types of businesses and collected by one central agency can result in greater equality in tax burden between the various types of financial institutions, and simplified and more efficient administration.

Method of Procedure and Source of Data

In order to test the three premises enumerated above and to prove or disprove the hypothesis it was necessary to conduct a systematic inquiry into the subject of Michigan taxation. Personal interviews were obtained with state and local tax administrative officials including representatives of the Corporation and Security Commission, the Banking Commission, the Insurance Commission, the Department of Revenue, and the city assessors' offices of Detroit and Lansing. In addition the writer attended Senate Finance Committee hearings, and served as part time Special Research Assistant for the Michigan Department of Revenue for two years under Mr. Clarence Lock, Deputy Commissioner. Two years were spent as graduate assistant in the Economics Department, Michigan State College, under Dr. Denzel C. Cline, Professor of Economics. Invaluable assistance was given by Dr. Cline and Mr. Lock in suggesting sources of data and offering guidance when most needed.

Published data in this specific field was found to be limited and unintegrated. After reviewing the general field of state taxation, Michigan statutes and annual reports of the various agencies were collected and analyzed. Personal interviews, departmental files and court decisions provided further facts and interpretations.

Definition of Terms

The term "financial institutions" has been variously defined. In the banking act of 1937[1] it is narrowly defined as any state chartered bank, trust company or small loan company. The 1953 Business Receipts Tax law[2] defines it as a business in which ninety percent of its assets consist of intangible personal property, or at least ninety percent of its gross income consists of interest and dividends. Boehmler (1949) describes it as an agency or institution that relates to, creates, or deals in money and promises to pay

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[1] Act 341, Public Acts of the Michigan Legislature, 1937. (Hereafter the Public Acts of Michigan will be designated P.A.).

[2] Act 150, P.A. 1953.

money, in transactions affecting private business, individuals or the government.[1] Insurance companies are included in Boehmler's study since they engage in lending money to private businesses and individuals. A similarly broad concept of the term "financial institutions" shall be used in this study. However, the term used hereafter shall refer only to the general categories of banks, building and loan associations and insurance companies.

The term "capacity-to-pay" shall be construed as meaning earnings or net income arising from the operation of a business.

Statement of Organization into Chapters

In describing the taxation of financial institutions in this study two approaches will be taken. The first is to discuss taxes, their origin, fiscal importance and general characteristics. This will be done in Chapters II, III and IV. Chapter II will present a brief overall picture of the growth and development of the present Michigan tax system noting constitutional limitations on legislating new tax measures, the shift from "ad valorem" to "specific" taxes, and the restrictions placed on the use of funds derived from these taxes. Chapter III will segregate taxes applicable to

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[1]Erwin W. Boehmler, editor, Financial Institutions, Department of Finance, School of Commerce, Northwestern University, September 1949, p. 1-2.

insurance companies, banks, and building and loan associations from the main body of Michigan taxes and will describe the significant features of the taxes governing such institutions. Chapter IV will be devoted to further evaluation of the premises of this study, that inequalities and inefficiencies exist in taxing the above named financial institutions.

To more clearly understand the impact of these taxes and the method in which they are administered on financial institutions the remaining chapters preceding the summary will give consideration to the type of role played in the economy, the business structure, and the tax problems of the various classes of insurance companies, banks, and building and loan associations in Michigan.

The final chapter will summarize the findings of this study and propose revisions to the tax system for financial institutions in Michigan which will result in more equitable distribution of tax burden and better administration of taxes.

CHAPTER II

THE MICHIGAN TAX SYSTEM

Introduction

Insurance company, bank, and building and loan association taxes are a small but integral part of the total Michigan tax structure. Before proceeding with a detailed discussion of individual taxes applicable to such institutions the general aspects of the Michigan tax system will be reviewed.

Limitations Imposed by State Constitution

The constitution of the State of Michigan prescribes that the legislature enact tax measures to cover contingencies of the state, as noted in Chapter I. It further prescribes the method by which these taxes may be imposed. Sections 3 and 4 of Article X of the Constitution of 1908 are as follows:

> "Sec. 3. The legislature shall provide by law a uniform rule of taxation, except on property paying specific taxes, and taxes shall be levied on such property as shall be prescribed by law: Provided, That the legislature shall provide by law a uniform rule of taxation for such property as shall be assessed by a state board of assessors, and the rate of taxation on such property shall be the rate which the state board of assessors shall ascertain and determine is the average rate levied upon other property upon which ad valorem taxes are assessed for state, county, township, school and municipal purposes.

> Sec. 4. The legislature may by law impose specific taxes, which shall be uniform upon the classes upon which they operate."

Under the Michigan Constitution of 1908 then there are two general methods of taxation which the state may employ, the legal terminology for which are "ad valorem" and "specific".

A great deal of litigation has resulted both before and after the adoption of the present Michigan Constitution as to the meaning of these two terms. As early as 1899 the legality of a Public Act of Michigan was questioned which required telephone and telegraph companies to pay, in lieu of all other taxes, a specific tax levied upon the assessment of telephone and telegraph lines at their true cash value at average rates for property taxed elsewhere within the state.[1] The Tecumseh Telephone Company contested payment of the tax on the grounds that it was unconstitutional inasmuch as it was not a specific tax but a tax on property and as such, did not conform to the uniform rule of taxation. Governor Pingree[2] also held that it was a property tax and ordered that the tax money under this Act which had been paid into the Primary School Fund be transferred to the State General Fund. The court ruled however, "It is not a specific tax and it is not within the uniform rule of taxation prescribed for

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[1]Act 168, P.A. 1881.

[2]Pingree v. Auditor General, 120 Mich. 95 (1899).

other property, and the law providing for it must therefore be held void." The court also stated that the constitution authorized only two kinds of taxation, "one, specific, imposed without regard to the value of the thing taxed; the other, general, based upon assessed cash value and requiring uniformity."

In the following year (1900) the Michigan Constitution of 1850 was amended to permit imposing specific taxes on property. This was done by causing Section 3 to read in part, "The legislature shall provide an uniform rule of taxation, except on property paying specific taxes, ..." The Michigan Constitution of 1908 included a similar provision, as noted earlier.[1]

Since 1908 a controversy has been waged over whether a tax according to value does not make it an ad valorem tax. Due to the ambiguity of the taxing articles of the constitution tax measures have been susceptible to attack on this point. Three instances relevant to the taxation of financial institutions may be cited. In Union Trust Company v. Detroit the court held that the mortgage tax was "specific" and not "ad valorem", although the amount of tax was computed by reference to the face value of the mortgage.[2] In Union Steam Pump Sales Company v. State it was held that the annual

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[1]See p. 12.

[2]170 Mich. 692 (1912).

corporation franchise fee is a "specific" tax although measured by the value of capital and surplus.[1] In the case of Shivel v. Kent County Treasurer[2] the constitutionality of the intangibles tax was contested on the grounds that it imposed an ad valorem tax without the uniformity required by Article X, Section 3 of the state constitution. The Michigan Supreme Court found however that, "The tax is specific, being levied directly ... upon ownership of designated personal property and cannot be held arbitrary, discriminatory or inequitable, and the rule of uniformity required by the constitution in the case of an ad valorem tax, has no applicability ..." The court did not give its reasons for holding the intangibles tax to be specific.

Tax study groups have recognized the need for changes to the tax article of the state constitution. The report of the Tax Study Commission of 1939 states:

> "The unsatisfactory and inequitable condition of Michigan taxation is due in part to traditions and ideas (or mere phraseology) now frozen into the constitution in form to meet conditions that were contemporary with their enactment. But conditions change, as when this state passed from an agricultural to an industrial economy. Tax concepts change accordingly. Therefore it devolves upon the legislature to maintain that fine adjustment between taxation and private economy which the community demands. It follows that the legislative powers should be broad rather than

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[1] 216 Mich. 261 (1921).

[2] 295 Mich. 10 (1940).

> narrowly circumscribed. Tax statutes of Michigan are written less often to conform to the constitution than to avoid its restrictive provisions."

The Michigan Tax Study Advisory Committee recommended in 1945 that voters be given the opportunity to eliminate the tax uniformity clause from the constitution and substitute in lieu of Sections 3 and 4 of Article X the following:[1]

> "The legislature may provide by law for the levy of taxes. It may confer by law upon units of local government such authority to levy taxes as the legislature may deem desirable. All taxes shall be uniform on the classes upon which they are imposed."

As of 1954 these recommended changes have not been made and new tax measures run the risk of being attacked on grounds of being unconstitutional.

Various attempts have been made to contrast "specific" and "ad valorem" taxes and to distinguish special types of "specific" taxes to provide a basis for classifying the various imposts levied in Michigan. Usually the result obtained is an arbitrary classification. Dexter[2] states that:

> "It is generally held that a specific tax is the same as an excise tax. The main difference between an excise and a property tax is that the latter is a tax on ownership as such and is considered a tax levied against property; while an

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[1] Michigan Tax Study Advisory Committee, "Preliminary Report, January 1945", p. 8.

[2] William D. Dexter, "Some Problems in Revising the Tax Article of the Michigan Constitution, Papers in Pub. Adm. No. 2, Bureau of Government, University of Michigan, Ann Arbor, Michigan 1948, p. 179.

> excise or specific tax is a tax imposed on certain incidents of ownership--sales, transfers, use, disposal, or receipt of property or claims to property."

A recent study by Ford and Waxman defines specific taxes as including the following types:

> "... (1) taxes on certain types of property that have been removed from the scope of the general property tax, such as automobiles and intangible personal property; (2) taxes based on various privileges, of which the following are representative: (a) sales tax--the privilege of engaging in the business of making sales at retail, (b) inheritance tax--the privilege of transferring property at time of death, and (c) annual privilege fee on corporations--the privilege of exercising the corporate franchise; and (3) the specific tax on the operative property of certain public utilities."[1]

It will be assumed for the purpose of this study that "ad valorem" taxes include only taxes on property not paying "specific" taxes as interpreted by the courts--thus, the general property tax. The term "specific" describes all other existing state and local taxes.

Relative Fiscal Importance of General Property and All Other Taxes

The general property tax has for years been, and continues to be, the major single source of revenue for local governments. Trends in the annual levy of the general

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[1]Robert S. Ford and Albert Waxman, "Financing Government in Michigan", Michigan Governmental Studies, No. 9, Bureau of Government, Ann Arbor, Michigan, 1942, p. 40.

property tax in Michigan since 1900 are shown in Figure I. Three distinct trends are indicated; first, an increase in taxes levied in the period 1900-1930; second, a decrease from 1930 to 1936; third, an increase from 1936 to 1950.

The most significant outcome of the period of declining property tax levies (1930-1936) was the adoption of a new source of revenue by the state. Upon the realization that the general property tax was no longer able to carry the burden of both state and local government financing, the state relinquished this source in 1934 in favor of a three percent retail sales tax.[1]

The growth in importance of "specific" taxes in the total revenue picture in Michigan can be readily seen by referring to Figure II. Of total taxes collected in the years prior to 1922 "specific" taxes never accounted for more than 15 percent. By 1930 they had at no time exceeded 25 percent of total tax collections. However, as new taxes were added and existing ones were revised, "specific" taxes replaced the general property tax as the primary source of revenue in Michigan. In 1949 "specific" tax revenues exceeded "ad valorem" revenues by $76 million or 26.5 percent. (See Figure II).

As with "ad valorem" taxes, three well defined trends in

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[1] Act 167, P.A. 1933.

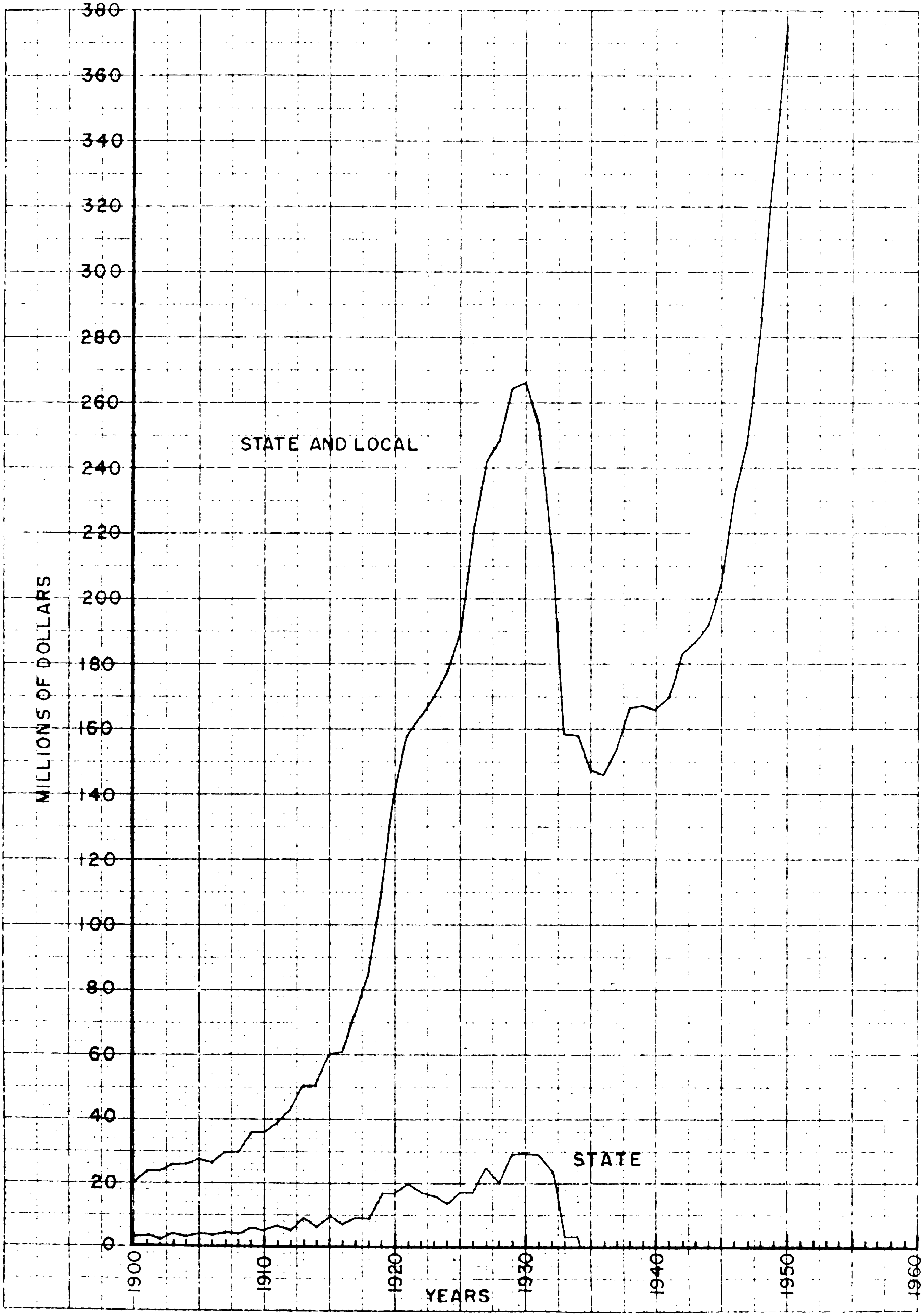

FIG. I MICHIGAN GENERAL PROPERTY TAX LEVIES, 1900 - 1951 total "specific" tax receipts may be noted in the first half of the century (Figure II). First, there was a marked upward trend in yields in the years prior to 1931. In 1913 revenues received from this source were $6.4 million and in 1930 had increased to $77.6 million (Table 2). Second, there was a pronounced downward trend in the depression years of the 1930's. Receipts fell $24.2 million in the period 1931-33. It may be observed that fluctuations in the annual yield of "specific" taxes in these first two stages paralleled the changes in property tax levies. The productivity of both methods of taxation is influenced by changes in economic conditions such as levels of prices and incomes and employment.[1] However, as will be noted for the following period, other factors may affect the trend in "specific" tax receipts. The third general trend (1933-1950) was induced by levying new taxes. Adverse economic conditions had created a serious fiscal problem for the state. Unable to wait for "better times" to raise the necessary revenue for financing government, the legislature introduced substantial new taxes. This caused the upsurge in total "specific" tax receipts to precede the upward trend in general property tax levies by four years.

For particular "specific" taxes the fluctuations in

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[1] Inheritance tax receipts excepted.

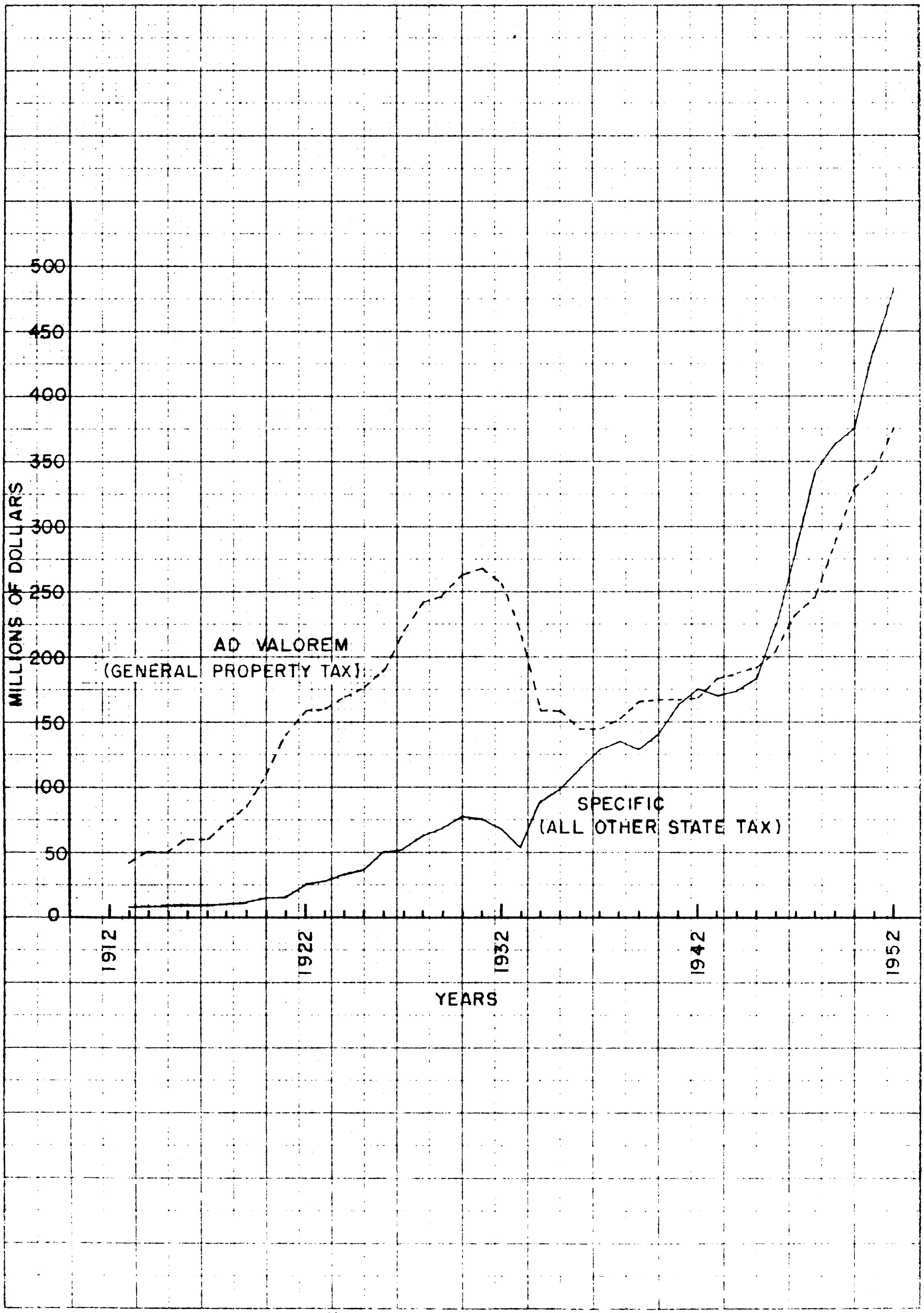

FIG. II TOTAL MICHIGAN "SPECIFIC" & AD VALOREM TAX REVENUES, 1912—1952

TABLE 2

STATE TAX RECEIPTS IN MICHIGAN 1913-1952*
(OTHER THAN GENERAL PROPERTY TAX)
($000,000)

	Public Utility	Insurance Company Premiums	Corporation Privilege	Sales and Use	Intan-gibles	All Other Specific	Total Specific
1913	4.9	.6				.9	6.4
1914	4.4	.7				1.4	6.5
1915	5.1	.7				1.5	7.3
1916	5.1	.7				2.5	8.4
1917	4.5	.8				4.2	9.5
1918	4.4	1.0				4.1	9.5
1919	5.9	1.1				4.3	11.3
1920	6.9	1.4				7.6	15.8
1921	6.9	1.8				8.7	17.4
1922	8.7	1.7	5.5			9.3	25.6
1923	8.4	1.8	5.5			12.4	28.2
1924	9.2	2.1	5.4			16.6	33.3
1925	10.3	2.4	6.2			18.6	37.4
1926	11.2	2.6	6.2			29.8	49.9
1927	11.5	2.9	6.5			31.2	52.1
1928	13.0	3.2	7.0			39.0	62.1
1929	13.0	3.5	6.9			46.5	69.9
1930	14.4	3.9	7.2			52.0	77.6
1931	14.5	3.7	7.5			49.6	75.3
1932	11.7	3.5	6.9			47.8	69.9
1933	7.6	3.1	5.7			37.0	53.4
1934	10.3	2.6	4.8	31.4		39.4	88.7
1935	9.4	3.0	4.8	38.6		40.3	96.0
1936	9.9	3.2	4.9	45.6		50.6	114.3

TABLE 2 CONTINUED

	Public Utility	Insurance Company Premiums	Corporation Privilege	Sales and Use	Intan-gibles	All Other Specific	Total Specific
1937	7.4	3.5	5.1	54.8		57.3	127.9
1938	8.6	3.9	5.2	52.9		63.4	133.0
1939	8.7	3.7	5.4	51.5		59.7	128.9
1940	9.0	3.9	5.4	60.4		61.3	140.0
1941	10.1	4.2	5.5	73.2	2.8	68.0	163.9
1942	9.4	4.8	5.9	83.3	3.0	68.3	174.6
1943	9.5	4.9	6.3	86.4	3.1	59.8	170.0
1944	9.6	5.4	6.7	92.9	3.5	56.8	174.8
1945	9.7	5.2	6.9	99.4	3.7	60.8	185.7
1946	9.8	6.6	7.2	118.4	6.3	76.9	225.1
1947	10.3	6.9	7.5	160.9	6.9	91.8	284.3
1948	10.7	8.2	8.5	189.9	8.7	115.6	341.6
1949	11.3	9.3	9.7	200.2	10.7	121.0	362.2
1950	12.9	9.8	10.7	204.2	11.3	127.0	375.9
1951	14.2	10.8	11.3	246.9	13.8	138.3	435.3
1952	14.9	12.1	25.7	245.5	12.9	173.1	484.2

*Public utility, foreign insurance company and corporation privilege taxes compiled from the annual reports of the Michigan Auditor General. Sales and intangibles taxes compiled from the annual reports of the Michigan Department of Revenue. Licenses and fees omitted, except Organization Franchise Fees.

revenue produced may be caused by changes in the base or rate of the tax, or both. The "specific" taxes considered in this study without exception, but depending upon time of enactment, indicate a general rise in revenue from 1913 to 1930 or 1931, a decrease from this date until 1934 or 1935, followed by a second rise continuing until 1950 (Table 2).

In this same 37-year period, however, the relative importance of individual taxes varied (see Table 3). Only the sales tax accounted for a higher percent of total "specific" tax receipts in 1949 than in previous years.

TABLE 3

PERCENTAGE DISTRIBUTION OF NON-GENERAL PROPERTY TAX REVENUES IN MICHIGAN*

	1919	1929	1939	1949
Public Utility	52.2	18.6	6.8	3.1
Insurance Premium	9.8	5.0	2.8	2.6
Corporation Privilege	--	9.9	4.2	2.7
Sales and Use	--	--	40.0	55.3
Intangibles	--	--	--	2.9
All Other	38.0	66.5	46.2	33.4
Total	100.0	100.0	100.0	100.0

*Computed from Table 2.

Since the adoption of the sales tax in 1933, this tax has been the largest single producer of specific tax revenue in

Michigan. By 1949, it was producing more than all other "specific" taxes combined and was second in productivity only to the general property tax in the total tax structure.

Disposition of "Specific" Tax Receipts

One additional factor contributing to the inflexibility and complexity of the Michigan tax structure is the constitutional limitation on the distribution of "specific" tax revenues. It was noted in Chapter I that these restrictions have created need for additional revenues for general fund purposes.

The revenue resulting from particular taxes is paid into the Primary School Fund of the state. The Constitution of 1850 required that,

> "All specific state taxes, except those received from the mining companies of the upper peninsula, shall be applied in paying the interest upon the primary school, university and other educational funds and the interest and principal of the state debt in the order herein recited, until the extinguishment of the state debt, other than the amounts due to educational funds, when such specific taxes shall be added to, and constitute a part of the primary school interest fund."[1]

The Supreme Court declared the state debt paid in 1881.[2] From that time until 1900, all "specific" taxes necessarily became part of the Primary School Interest Fund. In 1900 the

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[1]Michigan Constitution of 1850, Art. XIV, Sec. 1.

[2]Auditor General v. State Treasurer, 45 Mich. 161, 7 N.W.716.

constitution was amended to provide that,

> "All taxes hereafter levied on the property of such classes of corporations as are paying specific taxes under the laws in force on November sixth, A.D. 1900 shall be applied as provided .... in section one of this article."[1]

These revenues continued to be restricted by a provision of the Constitution of 1908 requiring that, "all subjects of taxation now contributing to the Primary School Interest Fund under present laws shall continue to contribute to that fund ...."[2]

In accordance with the above provisions, revenue from the foreign insurance company gross premiums tax is paid into the Primary School Interest Fund of the state. Taxes resulting from the retaliatory provisions of the act are called fees and, with other insurance licenses and fees, are paid into the State General Fund.

Revenues collected under the Annual Corporation Privilege Fee Act are credited to the State General Fund. The law was enacted in 1921 and there has been no subsequent restriction of revenues.

The retail sales and use taxes also have been until a recent date credited to the State General Fund as general purpose revenue. However, an amendment to the Michigan Constitution of 1908 adopted in 1946 diverted over 78 percent

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[1]Michigan Constitution of 1850, Art. XIV, Sec. 10.

[2]Michigan Constitution of 1908, Art. X, Sec. 1.

of the revenue from the sales tax to local governments and school districts.[1] The use tax continues to provide general purpose revenue.

The revenue from the intangible personal property tax is collected by the Department of Revenue and distributed to the cities, townships and villages in proportion to their population.[2] This allocation is made to recompense local governments for curtailment of their tax base due to the transfer of intangible personal property from the locally-administered general property tax to the state-collected intangibles tax in 1939. In 1951 the legislature placed a limit on the amount to be distributed. The limit specified was $11 million a year for two years, decreasing to $9.5 million a year beginning in fiscal 1953.[3]

The taxes in Table 4 accounted for 94 percent of specific tax receipts in 1949. This table illustrates the extent to which receipts from selected "specific" taxes have been restricted. Approximately 25 percent of these "specific" tax funds were paid into the State General Fund to be used for general purposes. The remainder were restricted to special purposes.

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[1] Ibid., Art. X, Sec. 23.

[2] An amendment adopted in 1949 permits the state to deduct three percent of gross collections for the cost of collecting the tax.

[3] Act 76, P.A. 1951.

TABLE 4

STATE TAX RECEIPTS - SELECTED TAXES*
($000,000 omitted)
1949

Tax	General Purpose	Restricted
Public Utility (other than Sleeping Car Companies)		$ 11.3
Insurance Premium		9.3
Corporation Privilege	$ 9.7	
Retail Sales	47.6	147.0
Use	5.3	
Intangibles		10.7
Automobile Weight		34.2
Gasoline		42.9
Cigarette	22.6	
Total	$85.2	$255.4

*Computed from Table 1 and State of Michigan Budget, 1949-50. Restricted amount for retail sales tax includes 33.3 percent of 1949 receipts plus 44.77 percent of 1948 receipts.

SUMMARY

The state constitution prescribes two general methods of taxation, namely, "specific" and "ad valorem". The "ad valorem" method requires that property be taxed at a uniform rate per dollar of assessed valuation. The "specific" method allows more latitude to taxing bodies and requires only that taxes be uniform upon the classes upon which they operate. All taxes other than the general property tax fall within this legal category.

"Specific" taxes have played an increasingly important role in the total tax structure. This is largely due to the introduction of the sales tax in 1933 at a time when general property tax revenues were declining. Other "specific" taxes made their introduction as, (1) the limitations of the general property tax were recognized, (2) the revenue needs of the government became greater and, (3) sales tax revenues were diverted to local governments.

General property tax receipts are retained by local governments and approximately 75 percent of "specific" tax receipts are restricted for special purposes or returned to local governments. Only the remainder of the "specific" tax receipts is credited to the State General Fund. This factor has been responsible for the search for new revenues and has focused attention on financial institutions as a possible source.

CHAPTER III

STATUTES GOVERNING THE TAXATION OF INSURANCE COMPANIES, BANKS, AND BUILDING AND LOAN ASSOCIATIONS

Introduction

The preceding chapter has described the general characteristics of the Michigan tax and revenue system and the factors influencing the enactment of new tax measures. With this as a background the purpose of the present chapter is to segregate all taxes paid by insurance companies, banks, and building and loan associations from the main body of state taxes. This is done to permit a more detailed analysis of governing statutes and the extent to which they apply.

Governing Statutes

As will be noted in Table 5, there are six Michigan taxes applicable to financial institutions. The table indicates the categories of business to which these taxes apply and the statutes governing them. A seventh tax has been omitted because of its relatively light incidence on financial institutions. This is the retail sales tax. The paragraphs which follow will trace the historical development of each of these taxes and outline the significant features of the present statutes.

TABLE 5

TAX SYSTEM FOR FINANCIAL INSTITUTIONS
1953

	General Property Tax		
	Real Property	Tangible Personal Property	Annual Corporation Privilege Fee
<u>Banks</u>			
National		Exempt National Banking Act of 1863 as amended Sec. 5219	Exempt National Banking Act of 1863 as amended Sec. 5219
State		Exempt Act 206, P.A. 1893, Sec. 9 as amended by Act 261, P.A. 1949	Exempt Act 182, P.A. 1952
<u>Building and Loan Associations</u>			
Federal	Applicable C.L. 1929 Sec. 3389	Applicable C.L. 1929 Sec. 3389	Permitted Title 12, Fed. Code Ann. Par. 1464(h)
State		Applicable C.L. 1929 Sec. 3389	Applicable Act 183, P.A. 1952
<u>Insurance Companies</u>			
Foreign			Exempt C.L. 1929 Sec. 10140
Domestic		Special provision, reduced base. Act 235, P.A. 1903	Exempt Act 180, P.A. 1952

TABLE 5 CONTINUED

Intangibles Tax	Foreign Insurance Company Gross Premiums Tax	Domestic Insurance Company Privilege Fee
	Not applicable	Not applicable
Tax paid in behalf of shareholders and depositors. Act 301, P.A. 1939 as amended.	Not applicable	Not applicable
	Not applicable	Not applicable
	Not applicable	Not applicable
Exempt Act 301, P.A. 1939, as amended Sec. 3	Applicable (except fraternal) Act 154, P.A. 1929	Not applicable
	Not applicable	Applicable Act 180, P.A. 1952

General property tax. The first comprehensive general property tax law in Michigan was enacted in 1817[1] and many steps were taken toward the present form of property tax by 1827.[2] The property tax did not become a source of state or territorial revenue until 1835[3] when it was used to defray the expenses of holding a convention to form a constitution and state government. It then continued to be the chief revenue producer for both state and local government until 1933.

The law provides that the general property tax be levied against the assessed valuation of all real and personal property except that specifically exempted by law. Property is to be assessed at its cash value as equalized and the rate determined by dividing the amount of the tax levy by the assessed valuation.

The total annual levy of the general property tax sharply declined from 1930 to 1936. This decline may be attributed to the economic depression of the 1930's. Incomes and property values dropped precipitously. For two years tax rates continued to increase but many property owners were either unable or refused to pay their taxes out of their

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[1] Territorial Laws, Vol. II, p. 109.

[2] F. M. Thrun, Handbook of Michigan Tax Laws, Circular Bulletin No. 153, Agricultural Experiment Station, East Lansing, Michigan, 1934, p. 14.

[3] Territorial Laws, Vol. III, p. 1410.

reduced incomes. The widespread opposition that developed was instrumental in causing the people to adopt a constitutional amendment in 1932 limiting the rate of general property taxation to 15 mills per dollar, or $15 per $1,000 of assessed valuation.[1]

As interpreted by the Michigan Supreme Court in 1935, this limitation did not apply to incorporated cities and villages unless they voted to place themselves under it.[2] Only eleven cities voted to do so. It is estimated that from one-half to two-thirds of the total general property tax levied in Michigan was levied by cities and villages not subject to the 15-mill limitation.[3] The 15-mill limitation became effective in 1933. After 1933, reductions in tax levies were made in certain municipalities in the absence of the limitation.[4]

The average property tax rate for all local assessment jurisdictions in the state continued to be higher than 15 mills after 1932 (see Figure III). There were two important reasons for this. First, as mentioned above, a large share

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[1]Michigan Constitution, Art. X, Sec. 21.

[2]City of Pontiac v. Simonton, 271 Mich. 647 (1935).

[3]Denzel C. Cline, Michigan Tax Trends as Related to Agriculture, Special Bulletin No. 301, Michigan State College Agricultural Experiment Station, East Lansing, 1940, p. 11.

[4]*Loc. cit.*

of taxable property in the state was not subject to the 15-mill limitation amendment. Second, such property as was included under this amendment could exceed the limitation for servicing debt contracted prior to December 8, 1932, the effective date of the amendment. Many local governments were deeply in debt and this accounted for much millage outside the limitation.[1] Although it has not been effective in reducing the average rate at any time below 25 mills, the 15-mill limitation has resulted in an average tax rate lower than might otherwise have prevailed. This is because large areas of the tax base considered in computing the average do have this limitation.

In spite of an increase in assessed valuations, cities which had voted themselves under the 15-mill limitation found they had insufficient finances to carry on the necessary functions of local governments. Nor were they able to acquire the two-thirds majority vote of the electorate to levy extra taxes above the limitation. Several factors operated to alleviate this situation. In 1946 the sales tax diversion amendment to the constitution was adopted. The effect of this was to require the return of nearly four-fifths of sales

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[1]The constitution also provided that extra millage could be voted but this had little effect because the provision allowed too short a time period (5 years) and needed a two-thirds vote of the electorate to confirm it.

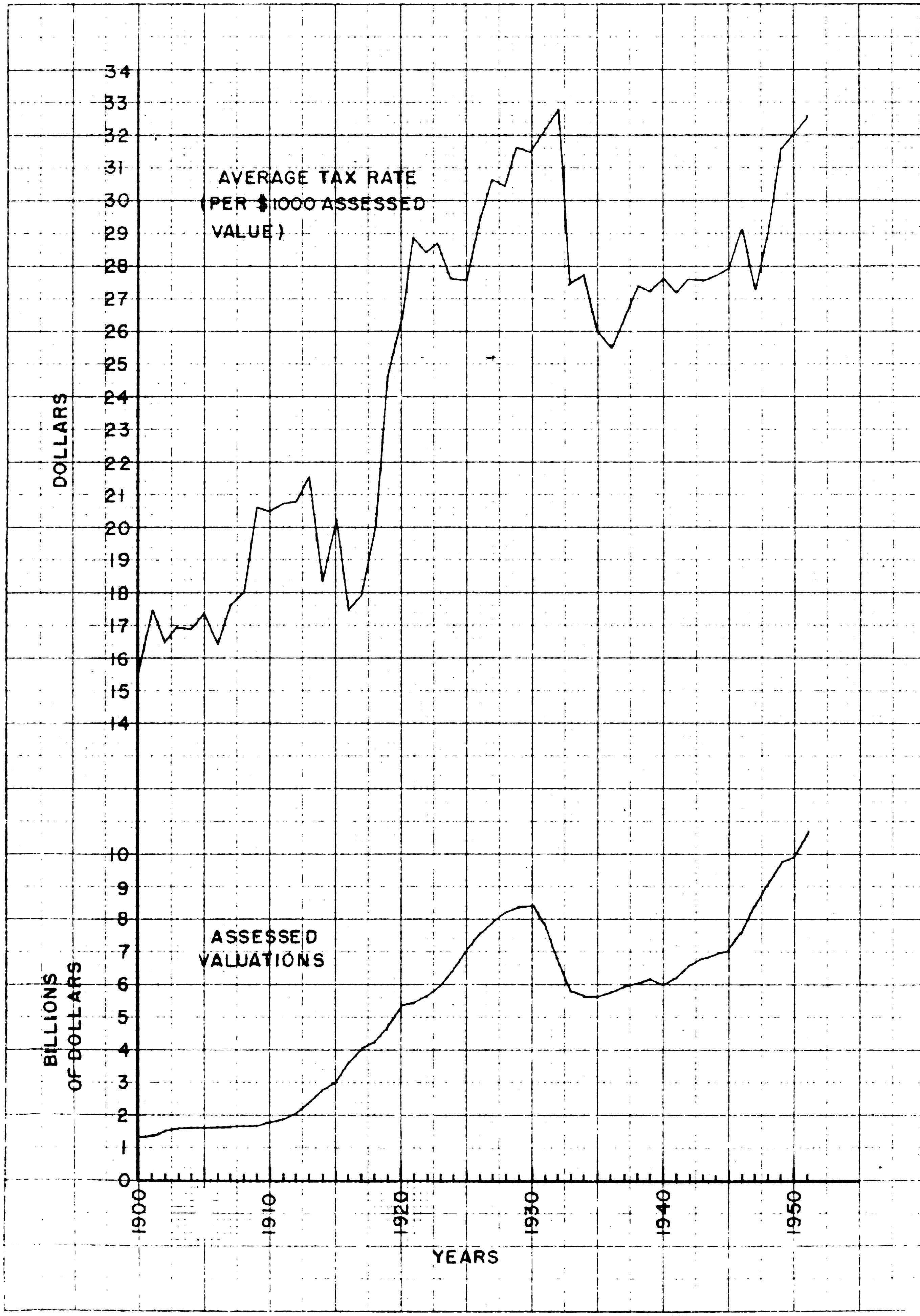

FIG. III GENERAL PROPERTY TAX, – ASSESSED VALUATION & AVERAGE RATES, 1900 - 1951 tax revenues to local governments.[1]

In 1948 the Michigan Constitution of 1908 was again amended to permit those cities which had voted themselves under the 15-mill limitation to raise the limit by five per-cent of the assessed valuation for a period not to exceed twenty years. This could be done by a majority of the electors in any assessing district.[2] Finally, in 1948, the legislature passed a law that there were no more 15-mill cities.[3] This removed such cities from the financial strin-gency which they had imposed on themselves fifteen years earlier.

The taxation of real property under the general property tax law applies to all financial institutions considered in this study. The coverage of the tangible personal property tax however is much less broad. Under the National Banking Act of 1863, national banks are exempt. Until 1949 no effort was made to assess the tangible personal property of state banks. To avoid discrimination against them the personal property tax was not invoked. However, in 1949 the state tax law was amended to specifically exempt the tangible personal property of state banks from taxation.

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[1]Michigan Constitution, Art. X, Sec. 23.

[2]Ibid., Art. X, Sec. 21, ratified November 2, 1948.

[3]Act 44, P.A. 1948.

All savings and loan associations must pay the personal property tax.

Insurance companies are taxed under a special provision in the law which permits them to be assessed on a much reduced base.

Insurance company gross premiums tax. A premiums tax payable by insurance companies chartered in other states (but doing business in Michigan) was introduced in 1861.[1] The occasion for the premiums tax was the inadequacy of the general property tax in levying upon insurance companies. Out-of-state companies had their home office buildings in other states and they paid no real estate taxes on them in Michigan. In addition, the bulk of their assets were held in the form of intangible property such as cash and investments. To tax such property at general property tax rates would have been prohibitive. As a result the state adopted a form of a gross receipts tax. Foreign companies were directed to pay the state treasury a specific tax of one percent on the gross amount of all premiums received on Michigan policies written during the year. This rate was increased to three percent in 1865.[2] Ten years later the tax rate on life companies was reduced from three to two percent which was the average rate

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[1] Act 54, P.A. 1861.

[2] Act 153, P.A. 1865.

for other states.[1] However, the rate for fire companies remained three percent.

In 1875, twelve years after the insurance premiums tax was enacted, the legislature enacted a second law stipulating that this tax "shall be in lieu of all other taxes in this state."[2] This, of course, nullified the effect of the general property tax entirely until 1917 when real estate owned and securities deposited in Michigan were again taxable.[3]

The gross premiums tax is applicable only to foreign insurance companies, except fraternal organizations. Domestic insurance companies are not taxed under this law.

Annual corporation privilege fee. The annual corporation privilege fee was adopted in 1921. Although amended in 1923, 1951 and 1952 this fee has provided the basis for taxing corporations until the present time.

At one time the practice in Michigan as in other states was to issue charters by special grant of legislature and then levy a charge against such corporations in an amount sufficient to cover costs involved in the procedure. These charges were not for production of revenue but were primarily

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[1] Act 223, P.A. 1875.

[2] Act 223, Sec. 16, P.A. 1875.

[3] Act 256, Pt. 2, Ch. 1, Sec. 19, P.A. 1917.

in the nature of fixed fees to cover expenses of providing services to corporations. Corporations at this time usually operated locally in the state in which they were chartered.

As the corporate form of business organization grew in importance and it no longer took a special act of legislature to obtain a charter, corporations were recognized as a convenient and lucrative source of revenue for the state. An organization tax was substituted for the fixed fee in 1891.[1] It provided that a fee of one-half mill be paid upon the capital stock of every corporation organized thereafter and upon the additional amount of stock of any corporation subsequently expanded.

This act was superseded in 1921 by an act intended to revise, consolidate, and simplify the laws relating to corporations.[2] This latter act added the annual privilege fee in addition to the organization franchise fee.

The annual privilege fee provided that every corporation organized or doing business under the laws of Michigan, except public utilities and foreign insurance companies, pay to the Secretary of State an annual fee of two and one-half mills on each dollar of its paid-up capital and surplus for the privilege of exercising its corporate franchise.

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[1] Act 182, P.A. 1891.

[2] Act 85, P.A. 1921.

Building and loan associations were taxed at a special low rate. The portion of taxable capital and surplus was computed by using the ratio of the corporation's property owned or used in Michigan to the entire property of the corporation.[1] In no case was the fee to be less than $10 or more than $50,000.[2]

The annual corporation privilege fee remained practically unchanged from 1921 to 1951. It was in its desperate effort to increase state revenues in 1951 that the legislature finally reviewed the corporation tax law. Legislation was enacted to increase the rate from two and one-half to three and one-half mills on each dollar of paid-up capital and surplus and the $50,000 tax ceiling was removed.[3]

The corporation annual franchise tax was again reviewed in 1952. The result was a revision of the law touching on the following points:[4]

1. The rate of the annual fee was increased from three and one-half mills to four mills on each dollar of paid-up capital and surplus.

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[1] Act 85, Sec. 4 and 5, P.A. 1921.

[2] Sec. 10140, Compiled Laws of Michigan (hereafter referred to as C.L.), 1929; Am. Act 13, (Extra Session) 1933.

[3] Act 277, P.A. 1951.

[4] Act 183, P.A. 1952, Sec. 3, 4 and 5.

2. The term "corporation" was defined as including "partnership associations, limited, co-operative associations, all joint associations having any of the powers of corporations, and .. trust ..., whether domestic or foreign".

3. The allocation formula for measuring the annual franchise fee for companies engaged in business in Michigan as well as other states was changed. Instead of using property ownership as the only factor, other factors were included to more closely reflect the volume of business done.

Banks and insurance companies are not taxable under the corporation annual franchise tax law. State chartered building and loan associations are taxed at a special low rate.

<u>Retail sales tax</u>. In general recognition of the fact that property could not continue to support the previous high level of taxes, and that local government would be called upon to maintain or exceed the then prevailing levels of health, welfare and education expenditures, the state was forced to relinquish its claim on the general property tax.

To support the General Fund in the absence of this source, the state adopted a three percent retail sales tax. This was a "specific" tax to be paid to the state for the privilege of engaging in certain business activities. The act provided;

> "There is ... levied upon and ... collected from all persons engaged in the business of making sales at retail, ... an annual tax for the privilege of engaging in such business equal to 3 per cent of the gross proceeds there of ...."[1]

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[1]Act 167, P.A. 1933, Sec. 2.

The intent was clearly to make this a "specific" tax. It was not on property itself, as the general property ad valorem tax, but on the privilege of selling property.

The sales tax proved to be a bountiful source of revenue for the State General Fund. In the first year it produced more than the state general property tax had ever produced in any one year, and receipts continued to mount until in 1946 they were four times the highest annual intake from the state general property tax. It was inevitable that less fortunately situated units of government should try to divert a part of this stream of money into their own treasuries.

As a result of the prodigious returns from the retail sales tax, the State General Fund experienced a cumulative surplus of $7 million in 1942.[1] As this surplus grew, 15-mill cities turned their attention to the sales tax as a possible solution to their dilemma.

The sales tax diversion amendment to the constitution was adopted in 1946.[2] The amendment has two distinct parts. The first part required the direct sharing of the sales tax with local governments and specified the formulae for distribution:

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[1] State of Michigan Budget, for fiscal year ending June 30, 1944, Lansing, Franklin DeKleine Co., 1943.

[2] Art. X, Sec. 23.

"There shall be returned to local governmental units and school districts by the method hereinafter set forth, one cent of a state sales tax levy on each dollar of sales of tangible personal property on the present statutory base. (not rate)."[1]

Since the sales tax rate is three percent, the amount which must be distributed directly as a shared tax has been equal to one-third of the total revenue from the tax.

The second part of the sales tax diversion amendment states that the legislature shall appropriate as additional aid to school districts an annual grant equal to a certain fixed part of the entire sales tax collected in the preceding year:

"The legislature shall hereafter make annual grants to school districts out of general funds, over and above all constitutional allocations heretofore and herein provided, in at least amounts which bear the same ratio to total state sales tax revenues of the preceding year which the legislative grants in the fiscal year 1945-1946 bore to said revenues of the preceding year."[2]

In effect this provision of the amendment meant that the school districts would be assured of as large a proportion of the sales tax revenues as they had received in 1945. The state supreme court determined this proportion to be 44.77 percent of total sales tax collections in the preceding

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[1] *Loc. cit.*

[2] *Loc. cit.*

fiscal year.[1] This in addition to the 33.33 percent included under the shared tax provision would divert 78.1 percent of the entire revenue from the three percent retail sales tax to local governments, leaving approximately 22 percent to the state for general purposes. This divergence has made it necessary for the state to seek out new sources of revenue to support the General Fund.

The sales tax underwent extensive revisions in 1949 in an attempt to curb tax evasion and eliminate obvious loop-holes.[2] The result was a clarification of the acts which permitted better administration by the Department of Revenue and closer compliance by the taxpayers.

Intangibles tax. The adoption of the Intangibles Tax Act is recognized as the greatest step forward in modernizing the Michigan tax system compatible with legal and constitutional restrictions.

Until 1939, most classes of intangible property, such as stocks, bonds, and bank deposits, were subject to the general property tax law. The law provided that they be valued by the local assessing officer and be taxed at the same rates as were applied to real estate. The result was unsatisfactory for two reasons. First, the rate was confiscatory. The

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[1] Detroit Board of Education v. Elliott (1947).

[2] Act 272, P.A. 1949.

average property tax rate in Michigan since 1920 has ranged from $25 to $32.80 per $1,000 of assessed valuation (see Figure III). This was equivalent to 2.5 to 3.28 percent. Intangible property with average earnings only slightly in excess of this rate could not carry the burden. Second, certain classes of intangible property could easily evade taxation by local assessors, while such property of banks and insurance companies could be listed in full resulting in a higher effective tax rate for these institutions. Consequently, most local assessing officers ignored the law in this regard and did not carry bank and insurance company property on the tax rolls.

The purpose of the Intangibles Tax Act adopted in 1939 was to subject intangible property to a special low tax rate, exempt it from other types of local taxation, and provide for state administration to reduce the possibility of such property escaping taxation.[1]

The act also expressly repealed two other taxes; namely, the "mortgage tax" which imposed a specific tax on mortgages and land contracts in lieu of all other general property taxes in Michigan,[2] and the "secured debts tax" which imposed

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[1]Act 301, P.A. 1939.

[2]Act 91, P.A. 1911 as amended, Secs. 3640-3649 incl. of the Compiled Laws of 1929.

a specific tax on certain secured evidences of indebtedness and non-Michigan government bonds, also in lieu of all other general property taxes in Michigan.[1] These two taxes served as precedents for the intangibles tax in the matter of classifying property for tax purposes and removing special classes of property from the realm of the general property tax.

The Intangibles Tax Act of 1939 as amended in 1945[2] provided for the imposition and the collection of a specific tax upon the ownership of intangible personal property which had a business situs in Michigan. For persons subject to the intangibles tax there were two bases for computing the tax. For non-income producing property, the rate was one-tenth of one percent of face value.[3] On income producing property, the tax was three percent of the income but not less than one-tenth of one percent of face value. Certain owners were exempt. Among them were benevolent, charitable and religious organizations, public utilities, insurance companies, banks, and savings and loan associations. The latter two paid the intangibles tax on shares and deposits in their institutions.

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[1] Act 142, P.A. 1913, Secs. 3654-3658 incl. of the Compiled Laws of 1929.

[2] Act 165, P.A. 1945.

[3] On stock which does not have a par value the rate was applied to "contributed value"--the average per share contribution to capital, surplus and other funds.

They in turn were permitted to charge the tax to their depositors and shareholders or assume the tax. A special low rate of one twenty-fifth of one percent applied to bank deposits and shares or deposits in building and loan associations.

At the time that the corporate franchise tax rate was increased in 1952, measures were also taken to increase the productivity of the intangibles tax. The law was amended to:

1. Increase the tax rate on income producing intangible personal property to three and one-half percent.[1]

2. Add a tax of four mills per dollar of book value on shares of stock of state and national banks and trust companies located in Michigan.[2]

In 1953 a five and one-half mill capital account tax replaced both the four mill bank tax and the basic three and one-half percent tax on share dividends.[3]

The introduction of the Intangibles Tax Act into the Michigan tax structure gives recognition to the fact that representative property does not in itself create any new tax paying capacity but that its income is dependent upon the productiveness of the tangible property which it represents. To levy a property tax, as distinct from a business tax, on intangible property at general property tax rates would be difficult to justify on grounds of equity.

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[1]Act 318, P.A. 1952.

[2]Act 320, P.A. 1952. This tax was in lieu of the annual corporate franchise tax on state banks.

[3]Act 9, P.A. 1953.

Domestic insurance company privilege fee. Until 1952 domestic insurance corporations paid the annual corporation franchise tax at the rate of three and one-half mills on each dollar of their paid-up capital and surplus. This rate was increased in 1952 to four mills. Mutual domestic insurance companies were exempt under these laws.

In 1952 all domestic insurance companies whether stock or mutual, profit or non-profit, came under the provisions of a new domestic insurance company privilege fee.[1] The law states that any such company shall:

> "for the privilege of exercising its franchise and of transacting its business within this state pay annually to the treasurer ... a fee of 5 mills upon each dollar of its paid-up capital, if any, surplus and unassigned funds, ... but in no case shall such privilege fee be less than $10.00 or more than $50,000.00."[2]

The proportion of taxable capital and surplus for companies doing out-of-state business is based on the ratio of premiums written in Michigan to total premiums written. Provision is also made to relieve domestic corporations taxable under the insurance privilege fee from paying the annual corporation franchise fee.

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[1] Act 180, P.A. 1952.

[2] Ibid., Sec. 1(a). At the time of the enactment of this law only the Standard Accident Assurance Company of Detroit was large enough to benefit by the upward limitation of $50,000. The law permits this company to pay the fee at a much reduced effective rate.

Business receipts tax. A recent addition to the category of "specific" taxes is a business receipts tax which became law on June 2, 1953.[1] This introduced a new type of tax in Michigan. Furthermore, it has no counterpart in the existing tax structures of other states. It has adopted many features of a gross income tax and is similar in other ways to net income and sales taxes.

The tax is imposed on persons engaged in business, including service occupations but not on wage earners or salaried employees. The tax is not on the ultimate transaction or on the final sale to the consumer, as a sales tax, but is imposed at each step along the line. The manufacturer, the wholesaler or jobber, and the retailer are each required to pay the tax.

A tax of 4 mills per dollar is imposed on adjusted receipts (or income) over $10,000. Utilities are subject to a special low rate of 1 mill per dollar. Certain items are deductable from gross receipts in computing adjusted receipts, such as taxes, materials, rents and interest. If the total of the statutory deductions does not exceed fifty percent of gross receipts, the adjusted receipts on which the tax is imposed will be reduced to fifty percent of the gross receipts.

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[1] Act 150, P.A. 1953.

Banks, building and loan associations, and insurance companies are specifically exempt from payment of the business receipts tax.

This tax which became effective on July 1, 1953 will expire on March 15, 1955. Adopted as an emergency measure to provide operating revenues for the state it nevertheless has introduced a new method of business taxation which cannot be ignored in formulating future state fiscal policies.

CHAPTER IV

EVALUATION OF THE TAX SYSTEM FOR FINANCIAL INSTITUTIONS

Introduction

It has been noted in the previous chapter that a multiplicity of taxes and exemptions are characteristic of the present system of taxing financial institutions in Michigan. It is reasonable to expect that this will result in inequitable tax burdens and inefficiency. Before determining whether or not this is true, it is necessary to clarify the meaning of the concepts "ability-to-pay" and "tax burden" as employed in this study.

Welch (1934) states:

> "The art of taxation consists principally of two things: first, the securing of an adequate income to meet the expenses incurred by the government, and second, the distribution of the burden of tax payments in an equitable and economical manner."[1]

In attempting to accomplish the above objectives, three theories of tax apportionment have been developed. The "benefit" theory is based on the belief that taxpayers should contribute in proportion to benefits they receive. The

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[1] Ronald B. Welch, State and Local Taxation of Banks in the United States, Special Report of the State Tax Commission, State of New York, Albany, J. B. Lyon Co., 1934, No. 7, p. 63.

"cost" theory is closely related to the benefit theory. Advocates believe that a firm should pay taxes equal to the cost of the government activities which it has incurred. The "ability" theory states that taxes should be levied according to some measure of the taxpayer's ability-to-pay. The ability-to-pay theory, measured either by property or income, has been the most widely accepted for many years. Largely this has been because of the difficulty in determining exact proportioning of benefits received or exact costs incurred.[1]

Much has been written on the limitations of using property values as a measure of ability-to-pay. Difficulties are caused by inequality of assessments, double taxation caused when intangibles are included in the tax base, and inability to reach income from services and other wealth creating activities. The most serious criticism is that property may have past or future taxpaying ability rather than present. A franchise tax measured by net income is able to avoid these difficulties.[2]

It has been stated that: "One of the more troublesome

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[1]By a narrowing of the definition of taxes, fees are now used where contributions are measured by cost or benefit.

[2]It is true that under the net income basis the large unprofitable concern, which absorbs benefits and incurs government costs, would pay no business tax. However, in Michigan this concern would pay a property tax on its realty and tangible personal property.

matters in business taxation is incidence .... Thus what is first thought to be a business tax may turn out, with further analysis, to be a tax upon the consumer."[1] Recent studies have indicated that confusion exists as to the actual incidence of business taxes and little will be known about this problem until analytical techniques are further developed and additional statistical data are obtained.[2] Business taxes may in some instances be shifted forward to the consumer or backward to other producers. However, they must initially be paid by the people who are responsible for the operation of the business. Therefore, as used herein, the term "tax burden" will refer to the initial incidence of the tax, except as qualified in the discussions of individual types of companies, and is defined as a percentage of net income.

Evaluation of Tax System

It is now possible to examine in greater detail the premises on which this study is based.

Tax bases. It has been held that existing taxes on financial institutions have been levied without regard to ability-to-pay as measured by net income. Reference to the

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[1] Harold M. Groves, "Financing Government", New York: Henry Holt & Company, 1946, p. 252.

[2] Richard A. Musgrave, "General Equilibrium Aspects of Incidence Theory", *Papers and Proceedings of the Sixty-fifth Annual Meeting of the American Economic Association*, Chicago, December 1952, p. 504.

following tabulation of taxes applicable to insurance companies, banks, and building and loan associations will bear this out:

Tax	Tax Base
General Property Tax	Tangible Property - assessed value
Corporate Privilege Fee	Capital and Surplus
Intangibles Tax	Intangible Property - income, face value and book value
Gross Premiums Tax	Gross Premiums Receipts
Domestic Insurance Company Privilege Fee	Capital, Surplus, and Unassigned Funds

The above taxes can be levied in the absence of net income or earnings.

Tax burden. A second premise to be evaluated is that inequities of tax burden exist between financial institutions of various types within the Michigan tax system.

It was noted in Chapter I that in the United States in 1945 manufacturing concerns paid 27.1 percent of their net profit before federal taxes in state and local taxes, trade associations paid 16.6 percent, banks and trust companies paid 11.0 percent, and insurance companies paid 5.5 percent.[1]

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[1] Computed from "Corporation Income Tax Data", U. S. Bureau of the Census, Statistical Abstract of the United States, Seventh Edition, Washington, D. C., 1949, p. 364-372.

No comparable data were available for building and loan associations.

The number of exemptions and low tax rates applicable to financial institutions illustrated in Chapter III suggests that the tax burden for such companies in Michigan is also low and also inequitably distributed. Investigation further justifies this conclusion. Table 6 indicates that the different types of financial institutions carry varying proportions of the tax burden with insurance companies and building and loan associations carrying the least. By comparison with state and local tax figures for the United States the conclusion can be drawn that Michigan taxes for financial institutions appear lower than the average for similar companies elsewhere in the United States.

The tax data listed in Table 6 cannot be directly compared with the rates for the United States. In the first place, fees and local taxes, though minor, are not included. In the second place, insurance companies chartered in Michigan which do business in other states are subject to taxation in those states. Only taxes paid to Michigan by Michigan insurance companies are considered. Lastly, the figures in Table 6 are for the year 1948 while the figures for the nation as a whole are for 1945.

<u>Administration</u>. A third premise of this study is that due to the complexity of the tax system for financial institutions, this system is difficult to administer, difficult

TABLE 6

COMPARISON OF STATE TAX REVENUES TO NET INCOME[1]
1948

Type of Business	Net Income Before Taxes	State Taxes Paid to Michigan by In-state Companies	Percent Taxes to Net Income
Banks	$33,227,000	$2,451,637	7.3
Building and Loan Associations	7,824,527	129,088	1.7
Insurance Companies	31,236,077	59,479	0.19

(1) Sources of data are as follows:

Net income for banks; U. S. Comptroller of the Currency, Annual Report, 1948.

Net income for Federal Chartered Building and Loan Associations; Statement of Operation - Michigan Associations, Federal Home Loan Bank, Indianapolis, 1948. For state charter associations, Report on Building and Loan Associations, Secretary of State, Lansing, 1948.

Net income for insurance companies; 79th Annual Report of the Commissioner of Insurance, State of Michigan. Figure represents total income less total disbursements adjusted for additions or deductions to policyholder's reserves.

State taxes paid; corporation privilege fee - computed from files of Corporation and Securities Commission. Intangibles tax represents amount assumed and paid for owners of shares.

to comply with, and therefore inefficient. Six taxes relating to financial institutions are administered by five different agencies and governed by more than ten different statutes. Agencies responsible for administering these taxes are:

Tax	Administrative Agency
1. General Property (Real)	Local Assessor
2. General Property (Personal)	Local Assessor
3. Corporate Privilege	
a. Building and Loan	Secretary of State
b. All Others	Corporation and Securities Commission
4. Intangibles	Department of Revenue
5. Gross Premiums	Department of Insurance
6. Domestic Insurance Company Privilege	Department of Insurance

Disregarding the general property tax, which may be considered a local tax in contrast to a state tax, the above state agencies by statute, are involved in some phase of the process of business tax collection. The "Little Hoover Group" has found that the results of these confused responsibilities are:

> "a. to magnify administrative collection costs
>
> b. to increase potentialities for tax revenue loss through evasion, through insufficient post auditing of taxpayers' accounts, and through looseness in collection administration that stems largely from statutory reasons;

c. not minor factors are the points of inequity and harassment that result from the taxpayers' point of view."[1]

The extent of the loss of revenue cannot be determined. However, it has been found that substantial amounts of revenue are overlooked each year from the lack of a unified system for collecting the above taxes. The "Little Hoover Group" cites one example.[2] Uncollected corporation privilege taxes for the two year period 1950-51 were estimated, on the basis of records of the Corporation and Securities Commission, to be close to $150,000. After careful study the Commission on Reorganization of State Government feels that the revenue expected from tax laws enacted in 1952 could probably have been found within the prior tax structure through more stringent enforcement of tax laws and streamlining of administrative function.

To combine all regulatory functions into a single department has not always resulted in satisfactory operations and other states are not generally following the practice. A single department does not satisfactorily represent the interests which separate groups have in the policies relating to their control. For this reason tax "determination" should

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[1] Michigan Regulatory Agencies, Staff Report No. 28 - Part I to the Michigan Joint Legislative Committee on Reorganization of State Government, Detroit, Michigan, May 1953, p. 28-31.

[2] Loc. cit.

remain with the specific agency which exercises regulatory control. In order to reduce some of the duplication of effort that exists between the four state agencies the function of tax "collection" could be centralized in one agency with resulting economy and productivity. The first steps have been taken in this direction. The Michigan Department of Revenue was organized in 1941 to unify state tax administration, to coordinate the collection of taxes designated by law, to provide special service for tax enforcement, to avoid duplication in state facilities and to offer advisory service on fiscal matters.[1] By act of legislature[2] the responsibility for the collection of delinquent corporation franchise and privilege fees is now centered in this department.

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[1]Act 122, P.A. 1941.

[2]Act 7, P.A. 1953.

CHAPTER V

TAXATION OF INSURANCE COMPANIES IN MICHIGAN

Introduction

The taxes applicable to financial institutions have been reviewed in the preceding chapters. In this chapter special attention will be directed to the problems involved in taxing insurance companies.

Types of Insurance Carriers

There are over eight hundred insurance carriers authorized to transact business in Michigan. They may be classified for tax purposes into companies chartered by other states, referred to as "foreign companies", and companies chartered by the state of Michigan referred to as "domestic companies". Domestic companies comprise approximately 17 percent of the total number.

A further clarification in terminology may be made by differentiating between stock and mutual companies. Stock companies are stock-issuing corporations operated for the purpose of making a profit and paying dividends to stockholders. Mutual companies on the other hand are of various types, the degree of mutuality being dependent upon the extent to which each is owned and operated by the participants in its particular plan. A reciprocal exchange is a type of mutual organization in which subscribers engaged in the same line of business are authorized to carry inter-insurance contracts with each other to provide indemnity among themselves against any legally insurable loss except life, health and accident. These contracts may be executed by an attorney or representative who is retained on an expense basis.

Origin of Present Taxes

The records showing the history of insurance company taxation in Michigan prior to the year 1861 are incomplete. Shares of stock of insurance companies and other corporations were specifically listed as liable for taxes as early as 1821 but the effectiveness of this act is questionable. At that time corporations were a new form of business in Michigan. They were granted special charters by the legislative council of the Territory of Michigan and the state legislature, and whatever taxes were due from them were specified in their charters. Many secured tax immune charters and paid taxes at will or not at all. No annual statements were required of these companies and it is impossible to know the success they attained or how many were in operation at any one time.

With the adoption of the Michigan Constitution of 1850, special charters for business companies were forbidden and it was decreed that the taxing of their property should be under the general property tax, the same as other businesses.[1] Since insurance companies and other financial institutions had a large proportion of their assets in intangible property, they paid correspondingly less tax on real property than industrial concerns. They were also treated favorably under the personal property tax because of the general laxity in the enforcement of this law. Much of the intangible property in Michigan was not being declared and in order not to penalize banks and insurance companies whose assets were listed, it was the practice to assess them on a very low percentage of their value.

An act was passed in 1882 to provide for more adequate taxation of corporate property. Taxable situs was defined and provision was made to exempt the property of corporations on which specific taxes had been paid. A special formula was employed in 1882 for computing the taxable property of domestic insurance companies which is as follows:

> "The value of the real property on which a company pays taxes shall be deducted from its net assets above liabilities........., and the remainder shall be the amount of personal property for which the company shall be assessed."[2]

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[1]W. O. Hedrick, "Financial and Tax History of Michigan", Michigan History Magazine, 1938, Vol. 22, No. 1, p. 80.

[2]Act 9, P.A. 1882. Act 206, P.A. 1893, Sec. 7.11 stipulated that the legal reserve required by the state was to be included in such liabilities but this has been the only change to date.

For over 65 years this formula has succeeded in keeping most of the personal property of domestic companies off the local tax rolls. Of 42 companies in one Michigan city studied, only two paid a personal property tax in 1948 and for these two the assessed valuation was less than $100,000. In 1940 the four insurance companies in another Michigan city submitted financial statements to the city assessor's office and indicated that they were paying, previously, no personal property taxes because the formula when applied resulted in a negative amount of taxable property. Thereupon an agreement was made between the insurance companies and assessor's office whereby the companies would pay a nominal arbitrary amount each year. This figure was usually arrived at by taking 85 percent of furniture and fixtures reported and applying the tax rate. In one case when a company which was known to be much larger than another paid a lesser tax, the smaller company was arbitrarily limited to the same amount.

Insurance companies, by being a party to such an agreement, may be able to divert legislative attention from the problem, but by so doing they show that they are apprehensive of the result should an inquiry be made. The report of the Michigan Committee of Inquiry into Taxation in 1923 gave the opinion that "this provision of the law granting this special privilege to insurance companies should be repealed and that they should be required to pay taxes on the same basis as other corporations." This would result in domestic companies assuming their share of the personal property tax burden and would place all cities on a uniform basis.

Annual Corporation Franchise Tax

On the state level there are three important specific taxes to be considered--the annual corporation privilege fee, the foreign insurance company premiums tax, and the domestic insurance company privilege fee. The corporation tax administered by the Michigan Corporation and Securities Commission is for the privilege of exercising a franchise and transacting business within this state. The law was originally enacted in 1921.[1] In 1923, the rate of the fee was reduced and the maximum and minimum limits were changed.[2]

The law which was effective until 1951 provided that "a domestic insurance corporation doing business under the laws of this state shall, at the time of filing its annual report with the Secretary of State, pay a fee of two and one-half mills upon each dollar of its paid-up capital and surplus, but in no case less than $10.00 nor more than $50,000." The portion of taxable capital and surplus was computed by using the ratio of the corporation's property owned or used in

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[1]Act 85, P.A. 1921.

[2]Act 233, P.A. 1923. Originally the fee had been three and one-half mills upon each dollar of its paid-up capital and surplus with a minimum privilege fee of $50.00 and a maximum of $10,000.

Michigan to the entire property of the corporation.[1] Foreign insurance corporations were specifically exempted. In order to raise revenue the rate was increased in 1951 from two and one-half mills to three and one-half mills,[2] and again in 1952 to four mills.[3]

In 1952 domestic insurance corporations were exempted from paying the annual corporation privilege fee when they became subject to a new tax law referred to as the domestic insurance company privilege fee.[4] The former tax was eliminated entirely from the list of taxes applicable to insurance companies.

Domestic Insurance Company Privilege Fee

The domestic insurance company tax applies not only to corporations but to mutuals as well. This in effect is the first state tax which has been levied on mutual insurance companies in the state of Michigan and is in response to the cry of discrimination against foreign companies discussed later in this chapter. This new annual fee on domestic companies is for the privilege of exercising a franchise and transacting business in this state. The law states that such

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[1] Act 85, P.A. 1921, Sec. 4 and 5.

[2] Act 277, P.A. 1951.

[3] Act 183, P.A. 1952.

[4] Act 180, P.A. 1952.

a company shall pay "... a fee of five mills upon each dollar of its paid-up capital, if any, surplus and unassigned funds..."

Foreign Insurance Company Premiums Tax

The most important insurance company tax in Michigan from the revenue standpoint is the premiums tax payable by foreign insurance companies.[1] This tax was introduced in the year 1861[2] and has continued, though extensively modified, until the present date. Previous to the enactment of the tax law in 1861, foreign insurance companies had been required to file an annual report with the state in order to obtain authorization to do business in this state. In that year, however, such companies were also required to file with the state annually, for tax purposes, a statement of the number of policies issued and the amount of premiums received during the year just terminated. Based on these reports, foreign companies were directed to pay to the state treasurer a specific tax of one percent (increased in 1865 to three percent[3]) on the gross amount of all premiums on Michigan policies received in money or securities during the year.

Disposition of specific tax receipts received much

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[1] Act 256, P.A. 1917, Sec. 17.

[2] Act 54, P.A. 1861.

[3] Act 153, P.A. 1865.

attention from state legislatures in these early years. By 1850 it had become a fixed practice to use railroad taxes to pay the interest on borrowed Primary School Funds and the constitutional convention in that year provided that not only railroad but all specific taxes[1] should be used, first, to pay the interest on educational funds, second, the interest and principal on the state debt, and third, the residue to increase the assets of the Primary School Fund. Therefore, it is interesting to note that the Premiums Tax Act of 1861 stipulated that tax receipts be "appropriated to the same uses and purposes as the specific taxes on railroad corporations are or hereafter may be."[2]

Following upon the affirmation in 1869 of exclusive state regulation of insurance companies by the Supreme Court decision in the case of Paul v. Virginia[3] the states broadened their insurance codes. The court held in this case that "issuing a policy of insurance is not a transaction of commerce", and for that reason policies issued by a company incorporated in one state to persons residing in another state are "local transactions and are governed by the local law." This necessarily meant that the powers of taxation

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[1]Except those received from the mining companies of the upper peninsula.

[2]Act 54, P.A. 1861, Sec. 9.

[3]4 Wall. 168 (1868).

and regulation as they then existed belonged to the states rather than to the national government. The decision in this case was followed by the courts for more than 75 years until 1944.[1]

That Michigan insurance company laws came under the impact of extensive revision is evident from the report relating to insurance submitted by the Secretary of State in 1870[2] in which it is stated that the Acts of 1869[3] "very materially raise the standard of excellence required of stock companies." These acts provided specifically for the taxation and increased regulation of life, fire and marine insurance companies. The tax rate for foreign companies was continued at three percent of premium receipts on Michigan business and provisions were made for examinations and larger deposits with this state for the security of policyholders. On the other hand, an exaction was made of domestic life companies in the form of a policy valuation fee of one cent for each thousand dollars insured to insure their solvency. This levy is still in effect.

The duties and responsibilities of administering the gross premiums tax became more cumbersome as regulation of

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[1] United States v. Southeastern Underwriters Association, 322 U. S. 533 (1944).

[2] First Annual Report of the Secretary of State of the State of Michigan, Relating to Insurance, 1870, p. 7.

[3] Acts 77 and 136, P.A. 1869.

insurance companies increased. It therefore became necessary in 1871 to establish an insurance bureau under a commissioner of insurance.[1] Taxes continued to be paid to the State Treasurer. However, all receipts were kept as a separate and distinct fund for the maintenance of the Insurance Bureau, upon which the Auditor General was authorized to draw warrants for salaries and other expenses. The act further stipulated that "in case of any balance to the credit of said fund, in excess of the necessary expenses of such bureau, it shall be transferred, at the end of the fiscal year, to the General Fund of the state."[2]

From this it would appear that the primary purpose of the insurance company premiums tax now was to provide revenue to cover the expense of the operation of the Insurance Bureau. However, an extract from a financial report of the Commissioner of Insurance in 1872 indicates that there may have been another purpose:[3]

FINANCIAL REPORT
Year Ending December 31, 1871

Fire Companies	$44,522.23	
Life Companies	51,172.99	
Total Receipts		95,695.22
Total expenses of Bureau and Salaries		6,034.35
Net Revenue to State		$89,660.87

[1]Act 108, P.A. 1871.

[2]*Ibid*.

[3]*Second Annual Report of the Commissioner of Insurance of the State of Michigan for the year ending Dec. 31, 1871*, p. xlcii.

This conclusion is further substantiated by the fact that while insurance laws were still being administered by the Secretary of State in 1870, the total receipts from the specific tax on premiums totaled $89,098.82 and expenses were estimated at $2,000.[1]

The law of 1871 also expanded the definition of gross premiums from "all premiums received in cash or otherwise" to include "all premiums agreed to be paid", the validity of which was later verified by the courts.[2] Thus it was determined that the amount upon which the specific tax should be calculated is the sum of the maximum annual premiums as set down in the policies on which premiums have been collected, and not merely the cash balance actually paid over to the company.

Retaliatory provisions. The next few years saw important changes made in life insurance premiums taxation, most of which were later incorporated into the laws of fire and casualty insurance companies. Each state was allowed to dictate the rates at which they would tax foreign insurance companies, and since there was no way of enforcing uniformity of rates between states, a situation was created whereby

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[1] First Annual Report of the Secretary of State of the State of Michigan, Relating to Insurance, 1870, p. xlix.

[2] Connecticut Mutual Life Insurance Company v. The State Treasurer. 31 Mich. 6,7 (1875).

Michigan and other states thought it expedient to adopt the so-called "retaliatory provision".[1] This required that a foreign insurance company pay to the Commissioner of Insurance of the State of Michigan, an amount equal to the charges imposed by the laws of its own state upon similar insurance companies of this state, provided that the charges of the foreign state were greater than those imposed by Michigan.

Actually, this type of retaliation means higher revenues for the states utilizing it. It assures the state of a definite minimum tax upon outside concerns and at the same time provides penalties against companies located in states imposing high rates on foreign companies. As a consequence, the taxation of foreign companies is governed by the legislation of other states, and not by the revenue needs of the retaliating state or by the comparative tax burden upon other businesses in that state. The taxes therefore are independent either of fiscal or equity considerations.

Further disadvantages of the retaliatory provision are that it imposes an administrative burden on the taxing officials of assessing foreign companies on the various bases prevailing in other states, and the burden of interpreting laws, rulings and court decisions. The matter of relations between states must also be considered. The National Tax

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[1] Act 80, P.A. 1871, Sec. 28.

Association in 1909 passed a resolution to the effect that "all retaliatory legislation (as to insurance taxation) be abandoned as contrary to interstate comity."[1]

Over one-half the states, however, have such provisions included in their premiums tax laws. There is small likelihood that such states will voluntarily relinquish the right to this income simply on the grounds of equity or other theoretical tax considerations. Retaliation can only be eliminated when all states have uniform tax rates and uniform deductions, and this is only conceivable under a system of federal regulation of insurance companies.

In 1943 the phrase "in the aggregate" was included in the retaliatory provisions of this state.[2] It made it possible to compare for tax purposes the combined amounts of licenses, fees, taxes, and deductions rather than comparing individual amounts, as for instance filing fees of one state against filing fees of the other. This counteracted the tendency of states to raise specific fees or taxes in retaliation to like increases by other states. It was a definite step forward in achieving more uniform taxation of

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[1] Proceedings of the National Tax Association, Third National Tax Conference, Vol. 3 (1909), p. 29.

[2] Act 155, P.A. 1943.

foreign companies.[1]

"In lieu of" provision. In 1875 the tax rate on life insurance company premiums was reduced from three to two per-cent to conform more closely to the average rate of other states. The act also made the very significant stipulation that "the specific tax herein provided for shall be in lieu of all other taxes in this state."[2] This has been responsible for much litigation in Michigan tax history. The provision was successfully contested in the case of Metropolitan Life Insurance Company v. Stoll where suit was brought against the insurance company to pay a county mortgage recording fee.[3]

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[1] For an example of the use of the "greater in the aggregate" provision, assume that Michigan and Indiana each charge three fees or taxes. An Indiana insurance company would pay on the Indiana basis for foreign companies, sixty, one hundred, and twenty dollars respectively, and on the Michigan basis for foreign companies, one hundred twenty, fifty, and twenty dollars respectively. Then if Michigan were to figure each tax individually, the Indiana company would have to pay the larger sum in each case and the total would be two hundred forty dollars. If, however, the fees were figured in the aggregate, the tax paid would be one hundred ninety dollars, the larger of the two state totals. Credit is given at the time of filing the annual report for fees paid in excess during the year.

[2] Act 223, P.A. 1875, Sec. 16. Later the words "except for real estate owned and securities deposited herein unless exempted under the general tax laws of the State" were added--Act 256, P.A. 1917, Pt. 2, Ch. 1, Sec. 19. In 1941 (Act 229) the law was again amended to provide for the taxation of tangible personal property owned or held for investment purposes by such companies within this state.

[3] 276 Mich. 637 (1936).

The court ruled that where two laws are in conflict, the one last enacted will control, and the exemption of foreign insurance companies from all other taxes did not extend to the mortgage recordation tax. Rather than enjoying complete protection under the law, insurance companies must now examine each new piece of proposed tax legislation to ascertain their tax status.[1] Since the "in lieu of" provision in its present form does not tie the hands of future legislatures, it has lost some of its fearful aspects. It may conceivably be used as a tool in better administration of taxes.

Pattern for new companies. From time to time as the state became more industrialized, as insurance business organizations became more complex, and they enlarged their scope of activity, new companies were allowed to organize and do business under the laws of Michigan. It was recommended in the report of the Secretary of State as far back as 1870 that a law be passed giving him authority over cooperative and mutual benefit associations and health and accident companies "to eliminate discrimination against stock insurance companies paying the tax on gross premium receipts."[2] In 1877 accident insurance companies of other states were permitted to do business in Michigan upon compliance with all laws in force

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[1]The corporation franchise tax specifically exempted foreign stock companies.

[2]First Annual Report of the Secretary of State of the State of Michigan, Relating to Insurance, 1870, p. 7.

relative to life insurance companies.[1] In 1883 mutual fire insurance companies were given the same privilege upon compliance with the laws applicable to stock fire insurance companies of other states transacting business in Michigan. Thus a pattern had been set and new companies were fitting into it.

However, it was not until June 1947 that cooperative and assessment associations were forced to conform.[2] At the 1943 session of the state legislature a bill was introduced to subject cooperative and assessment associations to the provisions of the premiums tax law but the bill died in committee.[3] The following year the Commissioner of Insurance wrote to the Tax Study Advisory Committee that he could see no reason why foreign cooperative or assessment associations should not be required to pay a premiums tax as well as stock and mutual casualty companies.[4] The saving to these companies in tax payments has been considerable. In the first year after the 1947 amendment was adopted three foreign companies, one each in Nebraska, Illinois, and Ohio, added

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[1] Act 42, P.A. 1877.

[2] Act 195, P.A. 1947.

[3] Michigan Senate Bill 29 (1943).

[4] Letter from the Commissioner of Insurance dated May 24, 1944 to Dr. Denzel C. Cline, Research Staff, Municipal Finance Commission and Tax Study Advisory Committee, Lansing, Michigan.

approximately $100,000 revenue to the state of Michigan.[1]

Insurance code. The Insurance Code which is now in force was compiled under Public Act 256 of 1917. This was more than a mere collection of existing laws. It was a complete revision and consolidation of the laws of the State of Michigan relating to the insurance business. All foreign insurance companies were required to pay a $25.00 annual filing fee, subject to retaliatory provisions, to the Commissioner of Insurance of this state.[2] Although it is not so stated in the law, it was understood at the time that these fees were to be used for the expenses of conducting the Insurance Department. In 1944, however, the department collected approximately $350,000 in fees and operated on a budget of approximately $130,000.[3] In 1947, revenues from fees were $311,443 and department expenditures were $141,629.[4] All excess is covered into the State General Fund as general purpose revenue.

Deductions. The Insurance Code further provided a system of deductions from the premiums tax base in order to

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[1]Information obtained from Insurance Department, State of Michigan.

[2]Act 256, P.A. 1917, Sec. 4. Fraternal organizations pay only an annual license fee of $5.00.

[3]Letter from the Commissioner of Insurance, op. cit.

[4]State Finances, U. S. Department of Commerce, Bureau of Census, 1946 Compendium.

provide for what was considered more equitable operation of the law. As amended, the law now reads that "every foreign insurance company admitted to do business in this state shall pay a tax upon its business written in this state, computed as follows:

> "First, Life insurance companies, a tax of 2 per centum on the gross premiums, excluding considerations for original annuities;
>
> Second, All casualty companies whether stock, mutual, cooperative, or assessment associations, a tax of 2 per centum on all premiums, deducting for premiums returned on cancelled policies, and reinsurance premiums received when the tax has been paid on the original premiums, and in mutuals, also deducting for dividends paid to members;
>
> Third, Fire, marine and strictly automobile insurance companies, whether stock or mutual, 3 per centum, on all premiums, deducting for return premiums on cancelled policies and reinsurance when the tax has been paid on the original premiums; and in mutuals also deducting for dividends paid to members."[1]

Dividends paid to members of mutual companies (except life) were considered repayment of excessive premiums received.

Disposition of revenue. At the time fees were adopted to cover the expense of operating the insurance department the revenue from the gross premiums tax was turned back into the General Fund of the state to be credited to the Primary School Interest Fund, the purpose for which it is still being

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[1]Act 256, P.A. 1917, Sec. 17.

used.

Southeastern Underwriters' Association case. The system of taxing insurance companies was tremendously shaken in many states with the advent of the Southeastern Underwriters' Association decision.[1] For 75 years the states had developed their own systems of taxation and regulation of insurance companies. In 1944, however, the Supreme Court held that "insurance transactions which stretch across state lines constitute interstate commerce so as to make them subject to regulation by Congress under the Commerce Clause."[2] The Commissioner of Insurance of this state and tax administrators of other states interpreted this to mean that state taxation of insurance companies must not place a burden on interstate commerce. If it did so, the regulation and taxation of insurance companies would transfer to the federal government with subsequent loss of revenue to the states.

Michigan at this time was one of ten states having a preferential system of insurance taxation which exempted domestic companies from the premiums tax levy. The Prudential Life Insurance Company of America filed its annual

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[1]United States v. Southeastern Underwriters' Association, 322 U. S. 533 (1944).

[2]The Constitution of the United States provides that Congress shall have power to regulate commerce with foreign nations and among the several states. Art. I, Sec. 8.

report with the Commissioner of Insurance on February 8, 1945 but refused to pay the tax because it claimed that the Southeastern decision had made the tax unconstitutional. When the Department of Insurance threatened to revoke all authority to do business in Michigan if the tax were not paid, an injunction was obtained enjoining the state from attempting to collect this tax. The Prudential Insurance Company was ordered to make a deposit equal to the amount of the premiums tax with the State Treasurer and the deposit was made. The amount of the tax deposited was $470,160 for 1944 and $504,559 for 1945.[1]

The Southeastern decision was having far reaching results in state tax systems. During this period eighteen states equalized rates between foreign and domestic companies and thirteen states repealed their retaliatory provisions. In Michigan two bills were introduced into the Senate embodying these changes. The first bill proposed to equalize rates between fire and marine and other insurance companies at a flat two percent. It also imposed a tax on domestic insurance companies at the same rate.[2] The second bill proposed to repeal the retaliatory provisions of the premiums

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[1]Report of the Treasurer of the State of Michigan, fiscal year ending June 30, 1947.

[2]Michigan Senate Bill 248 (1945).

tax law.[1] Both bills were strongly lobbied against by domestic companies.

Following the Southeastern Underwriters' Association case finding, Congress was asked to affirm by statute the right of states to regulate insurance. Apparently it had no desire to supersede the laws then in force in the states and it had no plan for taxing and regulating the insurance business. It therefore enacted a measure commonly referred to as the McCarran Act[2], in which is stated:

> "The Congress hereby declares that the continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States."

This eliminates any doubt as to the constitutional power of states to regulate and tax insurance companies. Neither of the revisionary tax bills introduced in the Michigan Senate were passed; and, as the validity of the McCarran Act was later determined[3], the Prudential Life Insurance case then before the Michigan Supreme Court was allowed to be withdrawn.

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[1] Michigan Senate Bill 249 (1945).

[2] Public Law No. 15, 79th Congress, approved March 9, 1945.

[3] Prudential Insurance Company of America v. Benjamin, 328 U. S. 408 (1945).

Exemption of domestic companies. Michigan in 1947 was one of eight states which did not tax the premiums received by domestic insurance companies. Thirty-eight states had equalized rates between domestic and foreign companies, and two states taxed domestic companies at a lower rate than foreign.[1] In the Prudential Life Insurance Company case, referred to above, it was established that in the year 1944 a domestic life insurance company of Michigan was required to pay aggregate taxes amounting to less than one-half of one percent of the premiums collected by it, whereas, all companies organized outside the state of Michigan were required to pay two percent of the gross amount of premiums received by them from policies covering risks within the state. If the domestic life insurance company had been required to pay on the same basis as a foreign company doing business in Michigan, the domestic company would have been required to pay approximately $31,000, whereas, the amount actually paid on Michigan business was $2,751.

The loss of revenue sustained by Michigan because of this discrimination is tremendous. It is estimated that in 1946 the tax payable by domestic companies on the premiums

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[1] State of New York, Insurance Department, Fees and Taxes Charged Insurance Companies, Albany, Williams Press Inc., 1947.

tax basis would have been approximately $1,032,822,[1] whereas, the corresponding tax paid was $53,723.[2] This resulted in a net loss to the state of about $979,099, or 15 percent of the present premiums tax income. Actually, this amount may be considered as a loading factor allowed domestic companies when their rates are established even though the tax is not actually paid. Hence, the effect of the discrimination is not to save money for Michigan residents who transact business with the domestic companies, but rather to increase the profits of the domestic companies. These companies have made the claim that by being subsidized in this manner they have been able to compete with the larger eastern companies and keep their rates down but this cannot be substantiated in such a highly controlled industry.

Theory of Insurance Taxation

Insurance companies present an unusual problem in the field of state taxation. As suggested earlier they have vast resources and a large variety of assets. The unique economic position they have due to the type of service they

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[1] Computed at 1941 rates from the Seventy-eighth Annual Report of the Commissioner of Insurance of the State of Michigan, Lansing, Franklin DeKleine Co., 1948. (Assessment farm mutuals exempted).

[2] Compiled from individual annual statements of all domestic insurance companies filed with the Corporations and Securities Commission.

perform has often caused them to be treated as a special privileged class of corporations. Additional complications have been introduced by the difference in ownership between stock companies and mutuals, the difference in types of risks undertaken, and the difference in reserve liabilities which arise.

The techniques used in setting prices from which the assets and income result, and which in turn become the source for taxes, have been well described by Howard Berolzheimer.[1] A resume of these techniques will prepare a background for the better understanding of tax issues discussed at a later point in this chapter.

Emphasis in all insurance is upon the loss which is shifted to the group. To make insurance work many participants are needed--the law of large numbers must operate.

For life insurance, experience has shown over a number of years what can be expected so far as mortality per 1,000 of population is concerned. Statistical measurements have been compiled for each age so that the chance of any person living through any year can be predicted. From observation of the past of a large number of persons, and of the frequency of death at all ages, mathematical probabilities are extracted. For expediency, these probabilities are then

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[1]Howard Berolzheimer, The Development of Principles in Insurance Company Taxation. An unpublished PhD thesis, Yale University, September, 1943.

transposed to a base table, starting at a given age with 100,000 lives, and a derived mortality table is the result.

In developing the premium it is necessary to assume (1) a mortality table, (2) the amount of the contract or obligation which the insurer is assuming, and (3) the age of the insured.

Another assumption must now be made in calculating the first year's insurance cost. The premium is paid to the insurer at the beginning of the year. No claims are paid until the end of the first year. Funds are invested and earn interest. Interest is fairly predictable. Thus, insurance companies operating on a "legal reserve basis" have established the practice of discounting the premiums giving the benefit of any interest earnings to the insured--even before such earnings accrue.

For any given group--given the above assumptions--the insurer is able to calculate the amount which will enable him to pay all losses contracted for. Yearly balances will be invested at such a rate of interest that the insurer will have the money necessary to pay future contracts as they mature.

It is customary for insurance to be sold on a level premium basis with the same premium paid each year rather than on a single premium basis. As a result, if a person dies, his contribution to the common fund is much less than if the total is paid at the outset. Also, since insurance is purchased to supplant income lost in the case of premature death, and premiums are to be paid out of income earned, it is more expedient to pay periodically.

There is a problem regarding the loading factor and reserves: In the operation of life insurance companies the great bulk of expenses in issuing a policy occurs the first year of the contract. A large part of the agent's commission, costs of medical examinations, issuance of policy, etc., do not recur. The insurance carrier must add to net premiums enough to recapture these expenses over the life of the policy. Well established companies are able to furnish funds out of surplus to write this new business. They then rely on gross premiums, i.e., net premiums and loading, to repay them for the initial costs of establishing the insurance protection. Other companies, both stock and mutual, are not able to furnish funds out of surplus. Since each policy is supposed to pay its own way the commissioners of insurance in the various states permit companies to apply for the privilege of "valuing the reserves" in such a way that borrowing is permitted from the policyholders' reserves in order to pay for these heavy first year expenses. The process of "valuing reserves" is important in the taxation of life insurance companies. Each premium in level premium insurance is thus composed of loading factors, mortality costs and reserves.

There are two forms of organization--stock and mutual. Stock companies issue non-participating policies. Mutuals distribute a part of their "earnings" each year to policyholders in the form of dividends. A large part of life insurance issued by Michigan companies is written by mutuals. Dividends are returned to their respective policyholders. The dividends which are paid to policyholders are subject to scrutiny since they may arise from savings on loadings, excess interest, or savings in mortality. They may also arise under practical conditions from terminations, sale or revaluation of assets and other sources.

Regardless of size, age or form of organization the cost of insurance to the insured is developed by using the above principles. Gross premiums may vary but they depend upon assumptions as to interest, mortality and loading.

These underlying ideas also hold for all types of property insurance. Funds are accumulated to meet uncertain losses, risks are transferred or combined, asset accounts are built up by premiums and from investment income. However, in other aspects property insurance is much different than life insurance.

In fire insurance no two risks are exactly alike and consequently every detail of every risk must be examined. Many, if not most, risks undergo frequent changes so must be re-examined and rerated from time to time. Many factors enter into making a fair assessment of fire costs such as construction costs, location, exposure, methods of heating and lighting, and extent of fire protection for every class of risk and every individual of every class. Therefore the price to charge cannot be measured with the same degree of accuracy as in life insurance. Adequate rates are necessary both for the security of the underwriter and the insured. Rates for fire insurance and other classifications are published by rating bureaus. Uniformity is achieved by the use of a schedule. When the base rate is determined from the schedule, additions and deductions may be made in individual cases.

Rates in all fields other than life insurance are based upon the attempt to measure the hazard of an individual risk and the premium charged is not a measurement of known losses, for fire losses vary widely from year to year.

There is more predictability of loss in the case of life insurance than other types of insurance. It is not unusual for an insurer of fire and casualty lines to experience underwriting losses for a series of years. Usually such losses do not mean the underwriter is financially insolvent, for investment income is usually sufficient to balance these losses and even show a profit. However, if losses continue it would indicate that the company is actuarially insolvent. In such a case, the Insurance Commissioner in the state where the company is domiciled would immediately take over and supervise the business for the protection of policyholders. These losses mean taxing fire and casualty companies is a different problem from taxing life insurance companies.

Life insurance companies must at sometime use premium income to pay the claims on a particular risk. Fire and casualty coverage is for short periods of time. The majority of the policies are of one or three years duration. As the contract runs out, the insured has received his service and all premiums are considered "earned" by the companies.

The distinction between "stock" and "mutual" fire and casualty insurance companies is that the fund of assets must be analyzed as well as income. Overcharges may appear which if not returned to the policyholder may result in a loss of mutuality. In a truly mutual situation when all overcharges are returned there can be no business profit in the economic sense.

Since the underlying principles for setting prices of insurance policies can be applied to all type of risks and carriers, net income for tax purposes may now be formulated as total income less total disbursements with the balance adjusted for additions or deductions to policyholders' reserves.

Before concluding that any one system will provide for equitable taxation of all insurance companies it will be necessary to review the tax system as it now exists and the problems associated with it.

Purpose of Taxing Insurance Companies

There has for many years been a point of contention between those who have insisted upon heavier taxes for the insurance business and those who have taken the view that no taxes whatever should be placed against such companies. In brief, legislatures have argued that large funds were accumulating in the treasuries of the life insurance companies and it was both politically and economically expedient to tax them. Proponents of the special privilege tax theory generally advance the following arguments:

1. Such taxes are a tax on thrift.
2. The insured unselfishly provides for the future of his beneficiary.

Most economists will not contest the first argument. Capital can be accumulated only through the process of saving. Most state taxes penalize thrift or reduce savings regardless of the type of business upon which they are levied.

The second argument, that the insured unselfishly provides for the future of his beneficiary, does not altogether conform to the facts. Policyholders are entitled to borrow on their policies and in a large percentage of cases avail themselves of this privilege. In 1932 policy loans represented 17.9 percent of total admitted assets.[1] In the period 1928-37 only 7.65 percent of life insurance written fulfilled the acclaimed purpose of providing for beneficiaries. The

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[1]*Proceedings*, 35th Annual Meeting of Association of Life Insurance Presidents, New York, 1941, p. 111.

balance was lapsed, surrendered, decreased, or expired.[1] The period considered is, of course, unique. But the fact remains that the unselfish motive is open to question. The insured frequently uses his cash value as he would a deposit in a bank and draws upon it for his own purposes when necessary.

The altruistic motive may even be questioned when the beneficiary does ultimately receive insurance. An individual may create an estate by having a life insurance company invest his money in stocks and bonds rather than his doing it directly. In this way he avoids payment of income taxes while his funds are being improved at compound interest.

It may be concluded that neither of the above arguments substantiate the principle that life insurance companies should be excused from paying taxes. These companies are productive in the sense that they do offer a service. From the operation of their business they produce an appreciable amount of income.

An equally hard fought controversy is whether mutual companies should be taxed. Advocates of the no-tax principle contend that there is a basic economic difference between stock and mutual companies: specifically, that mutuals do not earn profits. However, as illustrated earlier, policyholders in a mutual company receive dividends that have

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[1]Temporary National Economic Committee, Concentration of Economic Power, Hearings, Vol. 10, p. 4737.

elements of economic profit derived from investment of surplus funds. A policyholder has no contractual claim to these funds. Control of distribution of earnings rests in the hands of directors and paid managers as in the case of a stock company. Therefore, there is little economic difference between the two forms of organization.

Many former stock companies have now become mutuals thus avoiding payment of corporation taxes and in many states benefiting by reduced gross premiums taxes. Included in this group are (1) The Metropolitan Life Insurance Company, (2) The Prudential Life Insurance Company and (3) The Equitable Assurance Society of the United States. No essential change took place in the basic economic structures of these corporations. In fact before their mutualization they were also paying dividends to policyholders in order to remain competitive. Both stock and mutual organizations operate in competitive fields, give similar services, have assets of a like kind, and derive income from similar sources.

Based upon the above analysis the conclusion is drawn that neither stock nor mutual insurance companies should carry a lighter tax burden than other types of business simply on the grounds that they perform a different type of service.

Evaluation of Insurance Tax Bases

Historically insurance companies have been taxed on an opportunistic basis. Since insurance was held not to be an article of commerce[1] states have followed the rule of expediency in taxing such companies with an obvious lack of uniformity resulting. It has been established that the methods of taxing insurance companies in Michigan has had very little correlation with the capacity-to-pay of such companies.

The gross premiums tax levied on foreign companies is basically a gross receipts tax which, as has been stated before[2], has little actual relationship to the earnings of a company and does not differentiate between efficient and inefficient management. It has the advantage of ease of administration and high, stable tax yield. Certain deductions have been allowed by Michigan and other states with the result that the present tax may more correctly be classified as a "net" receipts tax.

The domestic insurance company privilege fee now levied in Michigan is fundamentally a form of book value tax. Book value is the excess of assets over liabilities and is represented in the balance sheet by the accounts called capital, surplus, and undivided funds. Book value is easily ascertained from the regular reports of insurance companies and provides a steady source of revenue. But there are numerous

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[1]See p. 68.

[2]Ch. I, p. 6.

objections to this method of taxing. First, a company's assets may be undervalued on its balance sheet. Second, mutual companies are taxed more lightly than stock companies. Through the device of obtaining excess premiums and the issuing of dividends, surplus accounts may be kept smaller.[1] Third, book values do not represent earning power.

It may be concluded that taxes levied upon insurance companies by the state of Michigan have these two points in common. First, they are easily administered and fairly stable; second, they are economically undesirable inasmuch as they are not based on capacity-to-pay.

Gamble (1937) states that the net income tax "is probably theoretically the best of all possibilities for insurance taxation."[2] Berolzheimer concludes that "The state tax on insurance carriers, both stock and mutual, on life insurance and those carriers other than life, should use net taxable income as a base."[3] This tax, though not in the Michigan statutes is well established in other states'

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[1]Philip L. Gamble, Taxation of Insurance Companies, Special Report of the New York State Tax Commission, Albany, New York, 1937, No. 12, p. 34.

[2]*Ibid.*, p. 40.

[3]*Op. cit.*, p. 143.

practices. Minnesota[1], South Dakota[2], Pennsylvania[3] and Louisiana[4] all use the federal income tax report as a base for computing state income taxes on insurance companies. North Dakota[5] has set up its own income tax. Other states use combinations of receipts taxes and income taxes.

The objections most frequently voiced to the net income tax are that it produces too little revenue, the yield is unstable, and net income is difficult to determine, particularly in the case of mutual insurance companies.

The first objection is indefensible inasmuch as the yield of a net income tax is dependent upon the rate of the tax itself and is limited only by the amount of profit insurance companies realize from their operations and "what the traffic will bear".

Stability of revenue is an important concern of the state. However, insurance taxes are a very minor part of the total state revenue received in Michigan each year. In 1952 total specific tax receipts were $484.2 million. The gross premiums tax receipts were $12.1 million.[6] Corporation taxes

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[1]Sec. 5973 Code (Minnesota).

[2]57. 3501-10 Code (South Dakota).

[3]Sec. P.L. 212, May 1939 (Pennsylvania).

[4]Art. 47, Laws 1940 (Louisiana).

[5]Ch. 312, Laws 1923 (North Dakota).

[6]See Table 2.

on domestic stock companies were approximately $60,000. Thus, taxes on insurance companies were only 2.5 percent of the total state revenue from specific taxes. It is true that a well established company may sustain losses for one or more years without actually becoming insolvent. During this period it has no tax paying capacity. Recognizing this fact it becomes all important that the tax system be flexible enough to avoid working an undue hardship on this company.

The most significant objection to using net income as the tax base for insurance companies is that net income itself is difficult to determine. Williamson (1934) concludes that this is sufficient reason for discarding this base in favor of a combination net receipts and investment income base.[1] Gamble states that although the net income tax is probably theoretically the best of all possibilities for insurance taxation it suffers from serious practical difficulty and strongly recommended the taxation of investment income as an alternative.[2] Berolzheimer while admitting the difficulties of determining net income concludes that the problem is one of account keeping and should not stand in the way of a sound economical tax system.[3] His thesis is that with

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[1]K. M. Williamson, "Some Problems in the State Taxation of Insurance", Proceedings of the National Tax Association, 1934, p. 401.

[2]Op. cit., p. 40.

[3]Berolzheimer, Op. cit., p. 114-116.

proper reporting by insurance companies net income may be determined for all types of companies, whether stock or mutual, life, accident or property, by applying the following formula:

> "the income subject to taxation should be total income .... less capital funds assigned to policyholders' reserves, less expenses of operation, less the actual return of capital to the policyholder termed dividends."[1]

That part of the dividend paid by mutuals which represents interest, rents, dividends on investments and profit on sale of assets is income to the company and cannot properly be allowed as a deduction from net income when paid out to the policyholder.

Comparative Tax Yields

As has been stated, the revenue from insurance company taxes in Michigan in 1953 was $13.4 million. Actual receipts from the gross premiums tax in that year were $13.06 million.[2] The domestic insurance company fee enacted into law in 1952 produced $339,726 in 1953.[3] It is virtually impossible to state what this would be in terms of net income since domestic companies are also carriers of insurance in other states and

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[1] Italics have been supplied.

[2] State of Michigan Auditor General, Financial Report, Fiscal year ended June 30, 1953, Part I.

[3] State of Michigan Budget for Fiscal Year Ended June 30, 1955, p. 4.

foreign companies are taxed by Michigan only on the premiums written in this state. It may be said, however, that the average insurance carrier in the United States pays only 5.5 percent of net income in state and local taxes[1] and since Michigan is one of eight states which does not tax local companies at as high a rate as foreign companies, in fact at less than 0.2 percent of net income (see Table 6), it may be concluded that Michigan companies pay less than the average rate. The saving appears to be considerable inasmuch as the majority of the premiums written by domestic companies are written in this state.

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[1] See Ch. III, p. 56.

SUMMARY AND CONCLUSIONS

Summary

In this chapter insurance companies were compared as to type of organization and type of risks covered.

The origin of present Michigan insurance taxes was traced and the operation of these taxes described.

The techniques for setting prices, determining net income and net worth were illustrated.

Popular arguments for not taxing insurance companies were analyzed.

The various tax bases presently employed in Michigan and other states were evaluated.

Finally an estimate was made of comparative tax yields for present and proposed tax bases.

It was found that:

1. The McCarran Act eliminated any doubt as to the power of states to regulate and tax insurance companies.

2. Michigan insurance taxes were adopted on the basis of political expediency rather than equity or other economic considerations.

3. Michigan is one of eight states remaining which discriminate against foreign insurance companies in their taxing policies.

4. There is no economic justification for not taxing insurance companies while other financial companies are taxed, or for distinguishing between stock and mutual insurance companies as to extent of tax burden.

5. Although requiring a more intricate system of account keeping it is possible to determine net income for all types of insurance companies.

6. A net income tax is theoretically the best tax for insurance companies.

7. The theoretic yield of a net income tax is limited only by the rate of the tax and the earnings of the companies concerned.

Conclusions

It is the tentative hypothesis of this study that a revision of the present tax system incorporating taxes based upon capacity-to-pay, equalized between types of companies, and collected by one central agency can result in greater equality in tax burden and simplified and more efficient administration. In this chapter an effort has been made to form a basis for testing this hypothesis with respect to insurance company taxation. Based on the findings of this chapter it is concluded that the desired results may best be accomplished by adopting a franchise tax based upon net income in lieu of all other state business taxes for insurance companies writing insurance policies in Michigan. Inequities such as discrimination in favor of domestic and mutual companies would thereby be lessened.

In order to make such a system operative a formula must be adopted to allocate for tax purposes a percentage of net income of any company which is equal to the ratio of premiums written in Michigan to total premiums written averaged with the ratio of investment income earned in Michigan to total investment income. It is also desirable that the tax be levied against net income based on a moving average of more than one year in order to allow the company to protect reserves.

It is recommended that the tax rate be set at a level compatible with tax burdens borne by other types of financial institutions in Michigan as discussed in the final chapter of this study.

It has been mentioned that authority for the regulation of insurance companies is vested in the Department of Insurance. For efficient administration, it is desirable that the tax collection function be segregated from that of insurance regulation and be transferred to the Michigan Department of Revenue which is staffed and equipped to standardize reporting procedures, audit accounts of taxpayers and collect taxes.

CHAPTER VI

THE TAXATION OF BANKS IN MICHIGAN

Introduction

There are approximately 435 banks and trust companies operating in the State of Michigan including 78 national banks, 346 state commercial banks, 3 industrial banks and 8 trust companies.[1] In 1949 these banks had deposits totaling $4,879,222,425 and total resources of slightly over five billion dollars. Michigan ranks twelfth highest among the states in the number of banks and eighth highest in the amount of deposits and total resources.[2]

The distinction between types of banks is largely in name only. The primary function of commercial banks is to accept demand deposits, to pay out these deposits by checks, and to lend funds at interest to commercial and other borrowers. In addition, they accept savings deposits, invest in non-commercial paper which is a function of investment banking, take orders from customers to buy securities which is a function of brokers, and act as trustees for individuals

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[1] State Banking Department, Fifty-ninth Annual Report of the Commissioner, for year ended December 31, 1947, Lansing, Franklin DeKleine Co., 1948.

[2] States ranking higher in amount of deposits are New York, California, Illinois, Pennsylvania, Massachusetts, Ohio, Texas.

and corporations which are the usual legal functions of trust companies.[1] Duplication of functions is further evidenced by the fact that by 1945, 280 banks had been granted industrial loan powers and 74 banks had been granted full or limited trust powers.[2]

The state and local taxation of banks in Michigan has been greatly complicated by the circumstances which surround their operation. In the first place, banks differ from non-financial institutions in the respect that they carry a stock of intangible assets consisting mainly of promises to pay, such as mortgages, bonds, notes and paper money. Secondly, they possess the monetary power of creating credit by loaning beyond their capital and reserves. The third circumstance adding to the complexity of the bank tax picture is that the 78 national banks operating in Michigan are chartered by the Federal government, and, as federal instrumentalities cannot be taxed by the states except by permission of the Federal government. The implications of this federal intervention in state taxing policy are widely felt in their effect on state banks and other financial institutions.

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[1] Charles L. Prather, Money and Banking, Chicago, Richard D. Irwin, Inc., 1946, p. 382.

[2] State Banking Department, Fifty-seventh Annual Report of the Commissioner, Lansing, 1946.

Federal Limitation of Bank Taxation

The subject of the historical development of federal restrictions on bank taxation has been ably treated in many recent studies.[1] Only the laws and court decisions of significance to the tax structure in Michigan shall be mentioned here.

The first legal case of historical importance in the taxation of banks dates back to 1819. At that time the State of Maryland was attempting to impose a stamp duty on the note issues of the Second Bank of the United States. The issue finally reached the U. S. Supreme Court, and in the case known as McCulloch v. Maryland[2] the court held that this action by the state was unconstitutional. Chief Justice Marshall proclaimed that "the power to tax is the power to destroy", and that the constitution could not be interpreted in any manner which would permit any of its instruments to be taxed out of existence. This decision established the legal principle that states could not tax the operations of agencies and instrumentalities of the Federal government. They

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[1] Among the sources of information used in the preparation of this section are: H. K. Allen and Constance C. Einhorn, Taxation of Banks, 1949; Harold M. Groves, Financing Government, 1945; Edward H. Saier, unpublished Master's thesis, State and Local Taxation of Banks in Michigan, 1937; Ronald B. Welch, State and Local Taxation of Banks in the United States, 1934.

[2] 4 Wheaton 316 (1819).

could, however, tax the real property of national banks, and also the interest which citizens held in these banks, provided such taxes were at the same rate as like property of the same description in that state.

Up until the time of the Civil War, the states and Federal government were apparently satisfied with this decision. Both methods were employed, the first quite universally.

With the onset of the war, the Federal government was faced with a serious problem of financing through the sale of government bonds. Consequently under the National Banking Act of 1863 a series of privately owned national banks were set up. There was no provision made for the state taxation of these national banks and the Act was inadequate in other respects. The Act was therefore revised in 1864 giving the states the right to tax national banks as follows: (1) all real property of national banks could be taxed, according to its value, but at the same rate as other real property in that state, and (2) shares of national banks could be taxed if (a) shares were assessed where the bank was located and (b) they were not assessed at a higher rate than "other moneyed capital" in the hands of individual citizens or higher than state bank shares.[1] The Act of 1864 provided

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[1]Sec. 41, Act of June 3, 1864, Ch. 106, 13 Stat. 99, 111-112.

that national banks should have lists of their stockholders open for inspection by tax officials. Ease of collection and assessment was further assured when the Supreme Court upheld a Kentucky statute requiring that the tax levied upon its shares be paid by the bank, acting as the legal representative of the shareholders.[1] Actually the share tax was on the shareholder rather than on the bank, but since collection was at the bank, it has always been classified as a bank tax.

The Banking Act was amended again in 1868. The new statute provided that in addition to taxing real estate, state and local governments could also tax bank shares as personal property to the shareholders subject to two restrictions, namely, "that the taxation should 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 nonresidents of any state shall be taxed in the city or town where the bank is located, and not elsewhere."[2] Two changes from the 1864 law are noted. First, no mention was made of the limitation that national bank shares were to be taxed at no higher rate than state bank shares. Second, the legislature of each state may determine whether the shares of

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[1]National Bank v. Commonwealth, 9 Wall 353 (1870).

[2]Act Feb. 10, 1868. C.7: 15 U. S. Stat. L. 34.

resident owners shall be taxed where the bank is located or at the residence of the owner. This amendment was later fused with the Act of 1864 into the now famous Section 5219 as it appeared in the Revised Statutes prior to 1923.

The law was further defined by an interpretation of the Supreme Court a few years later.[1] In this decision it was declared that the taxing provision in the National Banking Act was required to authorize the states to impose any tax whatever on national banks.

The effect of the statutory limitation, Section 5219, was to bring about a high degree of uniformity in bank taxation among the states and between state and national banks. The form of the tax was as important as the rate. While the federal law did not require that the same tax apply both to national and state banks, it did encourage such action. The states were free to tax their own chartered banks more heavily than national banks if they chose to do so, but they did not generally discriminate against them in this manner until around 1929 when the increasing pressure for revenue resulted in supplementary taxes.

The problem of most importance in national bank taxation since 1868 has been centered around the interpretation of the phrase "other moneyed capital". Before 1921 the general opinion was that other moneyed capital consisted of other

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[1] People v. Weaver, 100 U. S. 539, 543 (1880).

banking capital; in other words, that the states could tax the shares of national banks at any rate not higher than the rate on state bank shares. Many states in an effort to modify or improve the general property tax, adopted a classified property tax where bank shares were taxed at general property tax rates and other intangibles at a lower rate. "It was felt that this tax (share) was well administered and that banks were generally prosperous businesses quite able to pay taxes upon their intangible property."[1] In 1921, however, the U. S. Supreme Court in the Richmond Bank Decision held that "other moneyed capital" included "not only money invested in banking, 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."[2] This decision proved embarrassing for states using the classified property tax with a higher tax on bank shares than other intangibles. It left them with but two alternatives: (1) to tax bank shares at the lower rate, or (2) go back to including all intangibles in the general property tax base. Either choice meant a loss of revenue. In the case of reverting to the lower rate the reason is

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[1]Harold M. Groves, Financing Government, New York, Henry Holt and Company, 1946, p. 279.

[2]Merchants National Bank v. City of Richmond, 256 U. S. 635 (1921).

obvious. But by lifting all intangibles to the higher rate a loss of revenue would also be experienced as a result of driving intangible personal property from the tax rolls. Such was the case in several states prior to the enactment of classified property taxes with special low rates for certain classes of intangibles. Property holders tended not to declare their intangibles and the assessors were not always successful in discovering them.

These states exerted great pressure on Congress to change the law and in 1923, Section 5219 was amended to liberalize the taxation of national banks. Under this amendment the states could use one of three methods of taxing national banks. They could

1. Retain the old share tax, provided the rate of taxation was not higher than that assessed upon other moneyed capital in the hands of individual citizens of that state coming into competition with the business of national banks.

2. Tax net income, if the rate was not higher than that imposed on other financial corporations nor higher than the highest rate levied on business or manufacturing corporations.

3. Tax dividends on shares if the rate did not exceed that on other moneyed capital.

The tax on net income did not prove as satisfactory to the states as had been anticipated primarily because interest on tax exempt bonds was excluded from income and inadequate revenue could be derived. Consequently most states adhered to the share tax method. For reasons stated this method was onerous to banks and taxing authorities. The states united in 1926 to obtain the adoption by Congress of a fourth method of taxing national banks.[1] This method allowed the imposition by states of an excise tax upon the franchise of a bank, the value of the franchise to be measured by or according to entire net income from all sources.[2] Nichols (1950) after analyzing the litigation caused by the adoption of this provision stated:

> "There is now no question of the validity of a tax under the fourth method which includes interest on United States bonds which the state has no power to tax, as well as on its own (tax exempt) bonds."[3]

These four alternative methods of bank taxation under Section 5219 seemingly give the system a certain flexibility. The fact remains, however, that national banks, as distinct from other financial institutions are given special tax protection by the Federal government. The original National Banking Act was designed to protect national banks from discriminatory treatment and not to protect the banking business as a whole. Groves (1946) states:

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[1]Code of Laws of the U. S. in force January 3, 1935, Sec. 548, Ch. 4, Title 12.

[2]See Appendix B for provisions of this section.

[3]Philip Nichols, "The Interpretation of So Much of Section 5219 as Relates to the Taxation of National Banks Under the Fourth or Excise Method", Bank Tax Symposium, Committee on State Legislation, American Bankers Association, New York, 1950, p. 10.

"It is questionable whether the Federal government needs to protect national banks now that opposition to the system of national banking has ceased; certainly the government would be taking no chances by confining its control to the requirement that states may not discriminate in favor of their own banking institutions. The states have no disposition to do away with banking as a whole. The question of what taxes banks should pay might well be left to legislative discretion of the states. In effect the Federal government has been protecting not national banks but the banking business, from such taxes as state legislatures might see fit to impose."[1]

There has been considerable agitation for the relaxation of federal limitations on bank taxation in recent years but Section 5219 still dictates state policy in these matters.

Historical Development of Michigan Bank Taxes

The history of banks and bank taxes during the early years of Michigan's statehood reflect the turbulence of that period. The number of settlers grew from 87,000 in 1834 to almost exactly double that number in 1837. More land was bought and sold in Michigan during 1836 than had been bought and sold during the entire previous history of the territory.[2] This boom resulted in bringing bankruptcy upon the new state and with it many changes in Michigan's fiscal agencies and many changes in the tax system as will be noted.

The false prosperity of the land boom period (1834-36)

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[1] *Op. cit.*, p. 281-2.

[2] W. O. Hedrick, "Financial and Tax History of Michigan", *Michigan History Magazine*, 1938, Vol. 22, No. 1, p. 35.

was made possible by banks of the note-issue type. Transfers of realty made large money demands on these banks and they issued money to the extent of three times their capital stock. The profits from bank money issues were so large that more than sixty banks were chartered by the new state in its first year. During this same year the "safety fund" banking law was enacted.[1] This plan required the payment of periodic dues to the State Auditor as a safety fund for the use of creditors in the event of a bank failure. A second provision of the law was the provision for a State Banking Commissioner to supervise banks as to their business methods and enforce the safety fund law.

This period of bank prosperity did not go unnoticed by the State Legislature. In 1838 a specific tax of one-half percent upon state bank capital stock was imposed.[2] This law appears to have been badly applied. Hedrick states that under this tax law "bank tax receipts never exceeded a few hundred dollars per year, while bank capital stock at one time was in excess of forty thousand shares and many millions of dollars."[3]

From 1836 to 1843 a severe business depression swept over the country which caused most of the banks to go out of

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[1]Act 13, P.A. 1837.

[2]Revised Statutes of Mich., Ch. 8, Sec. 1 (1838).

[3]*Op. cit.*, p. 101.

existence and in 1842 only six banks remained. It was not until 1845 that a tax upon the real property of banks made its appearance.[1] Local units were granted the privilege of taxing the real estate of banks where the banks were situated but the new tax produced little revenue due to the limited number of banks. The feeling against banks remained so strong that the 1850 constitutional convention adopted a provision which ruled out any further special charters and forbade the enactment of any new Michigan banking law until a referendum of the people gave approval. This approval was finally secured in 1857 and banks were again lawful in Michigan.[2]

During the Civil War the enactment of the National Banking Act of 1863 was responsible for all but one state bank changing over to the new system of national banks. Since there was no provision for taxing these national banks other than a tax on real estate, Michigan tax receipts again fell. The former capital stock tax was ruled unlawful by the new banking act. The taxation of share values to stockholders as personal property, however, was allowed in 1864[3] and after a period of four years when national banks enjoyed almost

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[1]Revised Statutes of Mich. (1846), Ch. 20.

[2]Act 135, P.A. 1857.

[3]Act of June 3, 1864, Ch. 106, 13 Stat. 99.

complete tax immunity the Michigan Bank Act of 1867 was passed.[1] This new law provided for the taxing of bank shares to stockholders as personal property but further provided for collection at source. The tax on real estate remained as before.

The general property tax principle in this new law can be plainly seen. The same rate was used upon bank shares and bank realty as was used upon other local property in the bank vicinity.

Always present in the ad valorem method of taxation is the problem of proper assessment. Finding market values for stock shares which were seldom listed on the stock markets presented an insurmountable problem to tax assessors. In early practice this resulted in the assessor accepting the evaluation placed on bank shares by the bank itself. When the difficulties in this system were recognized the State Tax Commission endeavored to assist local assessors by providing them with valuations of bank stock shares computed by so-called experts.

Refinements continued to be made in administration until in 1929 it was written into the law that "shares in banks and trust companies ... doing business in this state ... shall be assessed at the cash value of each after deducting the per

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[1] Act 122, P.A. 1867.

share portion of (a) the assessed value of all real property ... and (b) the value of all securities ... which represent the investment of capital, surplus or undivided profits", but not deducting securities which are otherwise tax exempt.[1] This provision remained in effect until 1939.

As was noted earlier, state banks were not generally discriminated against although states were free to tax their own chartered banks at higher rates than national banks if they chose to do so. In the period 1927 to 1934 increasing pressure for revenues caused many state legislatures to levy supplementary taxes against state banks. By 1934 thirty-two states had levied one or more supplementary taxes on their own banks.[2] In 1929 Michigan included banks under the corporation privilege tax of two and one-half mills per one dollar book value of capital and surplus with a minimum tax of $10.00 and a maximum of $50,000.[3] This was imposed upon both national and state banks and trust companies but was unenforceable except for state banks.

In order to alleviate the difficulties of assessment inherent in the ad valorem tax on intangible personal property at general property tax rates several attempts were made

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[1]C.L. 1929, Sec. 3396, p. 8.

[2]Welch, Op. cit., Table II, p. 19, 20.

[3]C.L. 1929, Sec. 10140.

prior to 1939 to introduce a "specific" tax on such property. Bills providing for the low-rate taxation of intangibles were introduced in the Michigan legislature in 1935[1] and 1937.[2] Both were defeated. The second bill was strongly opposed by small loan companies because it was in the nature of a tax upon gross interest which in their case allowed no deduction for operating expenses or to cover delinquencies. Domestic business corporations also objected because it had been a practice to exempt stock of domestic corporations held by Michigan residents. The new provisions placed shares of foreign and domestic corporations on a parity for taxation purposes. Another factor contributing to the defeat of the 1937 bill was that municipalities desired to have all proceeds from the tax returned to them instead of the proposed two-thirds.

However strong the objections were, this bill formed the basis for the first Michigan Intangibles Tax which was enacted into law in 1939.[3]

The constitutionality of the new law was established in 1940 when it was upheld by the Supreme Court of Michigan in the case of Shivel v. Kent County Treasurer. In this case

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[1] Michigan House Bill, No. 566, Regular Session, 1935-36.

[2] Michigan Senate Bill, No. 246, Regular Session, 1937.

[3] Act 301, P.A. 1939.

the court stated, "The tax is specific, being levied directly by legislative enactment upon ownership of designated personal property and cannot be held arbitrary, discriminatory or inequitable, and the rule of uniformity required by the Constitution in the case of ad valorem tax, has no applicability ... The tax in question is uniform upon the classes upon which is operates ... The act is valid ...."[1] The Intangibles Tax Act adopted in 1939 provides that intangibles taxed as income producing or non-income producing property, or expressly exempt from the intangibles tax, are exempt from all general property taxes.[2] All banks and trust companies were exempt from the Michigan intangibles tax on their own intangible personal property.[3] The Act, however, provided that such banks should pay the tax in behalf of their shareholders and depositors and the tax so paid could be charged to the shareholder for whom it was paid or could be assumed by the bank.

With the introduction of a tax law as revolutionary as this one a proving-in period followed by changes to make the law more equitable and more clearly defined for administrative purposes was inevitable. The first amendment came in

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[1] Shivel v. Kent County Treasurer, 295 Mich. 10 (1940).

[2] Act 301, P.A. 1939, Sec. 2.

[3] Act 301, P.A. 1939, Sec. 3, Subd. 11.

1941 and provided among other things that the tax be administered by the Michigan Department of Revenue instead of the State Tax Commission.[1] Further changes were made in 1945[2] as the result of study and recommendations made by the Michigan Tax Study Advisory Committee.[3] This study found that the intangibles tax law was generally unsatisfactory on many scores. It caused unfair discrimination in the treatment of taxpayers, it was a complex law and hard to administer, and it produced an unduly small amount of revenue. In 1943-44 the amount of tax contributed from all the intangible personal property owned in Michigan was less than two percent of the amount contributed from the tax on real estate and tangible property. Consequently, the 1945 revision incorporated many of the changes which the Advisory Committee proposed. A specific formula was included for the allocation of intangibles belonging to corporations doing business in other states as well as in Michigan. The $3,000 exemption on bank deposits and building and loan shares was eliminated. In addition, the entire proceeds of the intangibles tax were earmarked to be returned to local units of government on a population basis. Cities and villages were to use the

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[1]Act 233, P.A. 1941.

[2]Act 165, P.A. 1945.

[3]Michigan Tax Study Advisory Committee, <u>Preliminary Report</u>, Lansing, 1945, p. 27.

receipts for general fund purposes; townships for capital improvements and maintainance of roads.

The condition of state finances following adoption of the sales tax diversion amendment resulted in legislation for the recovery of some or all of this intangibles tax money. In 1951 the legislature limited the amount that could be distributed to any one year to 11 million dollars.[1] This was later reduced to 9.5 million dollars beginning in fiscal year 1953.[2] The excess was earmarked for payment of state bonds issued for improvement of mental hospitals. In 1953 the intangibles tax produced $16,112.001. The effect of the 1953 limitation was to recover for the state approximately $6.6 million.

In 1952 measures were also taken to increase the productivity of the Michigan intangibles tax. The law was amended to increase the tax rate on income producing intangible personal property from three to three and one-half percent.[3] There was also added a tax of four mills per dollar of book value on shares of stock of state and national banks in Michigan.[4] This tax was in lieu of the annual corporate

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[1] Act 76, P.A. 1951.

[2] Act 181, P.A. 1952.

[3] Ibid.

[4] Act 182, P.A. 1952.

franchise tax. The four mill tax was repealed in 1953 and a new tax substituted which increased the rate to 5.5 mills on capital account and exempted bank stock from the three and one-half percent tax on dividends.[1]

Present Bank Taxes in Michigan

Banks now doing business in Michigan are exempt from all major taxes except the general property, sales, and intangibles tax.

The real property of banks is assessed by local governments as other real property is assessed. The Sales Tax Act (Section 4) was amended in 1949 to permit sales to national banks to be taxed.[2] This was done to equalize taxes between state and national banks. The amendment made it clear that since national banks were not wholly owned by the United States a tax on them could not be considered a tax on the Federal government. This eliminated to some extent the discrimination between state and national banks.

As has been described in the preceding paragraphs the intangibles tax has gradually evolved into a major source of revenue for state and local governments. It has also become a major state impost on state and national banks displacing the corporation franchise tax on the capital and surplus of

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[1]Act 9, P.A. 1953.

[2]Acts 272, 273, P.A. 1949.

state banks and creating a new tax on national banks.

The operation of this law as relates to banks, warrants a detailed description. Banks doing business in this state now pay intangibles taxes under two separate provisions of the law.

The first provision is that all banks shall pay the intangible personal property tax in behalf of their depositors either assuming payment or collecting payment from the depositor. The rate of this tax is one twenty-fifth of one percent of the face value of money on deposit.[1]

It has been mentioned that banks may assume the tax paid in behalf of their depositors or may charge their accounts for the amount of the tax. A study made in 1945 indicates that 91.4 percent of the banks in Michigan assumed payment of the tax on deposits. Only thirty-eight banks charged back the amount of the tax to the owners.[2] It now is general practice for banks to assume this tax.

The second provision, adopted in 1952, is that a tax shall be levied upon bank shares. The law reads:

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[1] This rate also applies to the individuals who have money on hand or in transit.

[2] Source - Michigan Department of Revenue.

> "The tax on shares of stock of state and national banks and trust companies located in Michigan shall be 4 mills per dollar of book value, in addition to the tax payable under section 2 of this act. Such additional tax shall be in lieu of any annual corporate privilege fee or other annual franchise tax upon such banks and trust companies. "Book value" as referred to herein shall mean that proportion of total capital, surplus and undivided profits as of December 31st of each year represented by each share of stock outstanding as of that date."[1]

The purpose of this levy was to alleviate the discrimination between state chartered and national banks. It has been noted that the corporation franchise tax applied only to state banks since national banks are not chartered by the State of Michigan. By the expedient of adopting the four mill intangibles tax on the book value of shares in lieu of the corporate franchise tax the shares of all banks were taxed at an equal rate.

This is the second instance in four years that steps have been taken to equalize taxes between state and national banks, the first being the levy of taxes on sales to national banks in 1949.

In 1952 when the four mill bank tax was adopted banks were also being assessed under a third provision of the intangibles tax; that all banks pay in behalf of their shareholders a tax of three and one-half percent of income produced by shares but not less than one-tenth of one percent of

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[1] Act 182, P.A. 1952, Sec. 2a.

the face, par, or contributed value of such shares. However, this provision was eliminated in 1953 when a five and one-half mill capital account tax was levied replacing the four mill levy and exempting bank stock of the basic three and one-half percent income tax on dividends. There are therefore now only two provisions of the intangibles tax applicable directly or indirectly to banks; the deposits tax and the capital account tax. These taxes are assessed on both state and national banks.

At the time of the adoption of the Intangibles Tax Act, one problem was that of devising a method of taxing banks that would yield approximately the same amount of revenue as was obtained by taxing bank shares at the general property tax rate. From 1939 to 1945 the revenue from banks fell far below the general property tax yield of prior years. Beginning in 1945, bank intangibles tax receipts were increased by providing that the tax on bank deposits be collected at source. Of $2,388,659 of intangibles taxes paid by banks in 1951, $328,974 was paid on shares and $2,060,771 was paid on deposits.[1] In 1951 state banks also paid a corporate franchise tax. In an address before the American Bankers'

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[1]State of Michigan, Department of Revenue, as reported in Michigan Tax Survey - 1952. A report from the Michigan Tax Survey Advisory Committee, submitted to the Legislative Interim Tax and Revenue Committee, February 21, 1952, Table 42, p. 92.

Association, Cudlip (1950) stated:

> "An intangible personal property tax is clumsy, but the difficulties presented can well be suffered so long as the tax rate is as low as it is in Michigan. I know most bankers prefer this system to an ad valorem tax. Further, the financial burden is less than if an excise tax were levied measured by bank earnings."[1]

In March of 1954 the five and one-half mill share tax has been in effect less than one year and no revenue figures are available. However, since the four mill share tax was levied at approximately the same rate as the corporation franchise tax which it replaced and the increase in millage to five and one-half was intended to replace the revenue from the income tax on share dividends it may be concluded that the effective tax rate on state chartered banks has not increased through recent changes in tax legislation.

Some indication of the burden of business taxes on Michigan banks may be gained by referring to the base year of 1951 and applying present (1953) rates. Only the intangibles tax applies since the corporation franchise tax has now been eliminated from the list of taxes applicable to banks. It has been noted that the tax on deposits produced $2.06 million in 1951. To this must be added the revenue that would have been produced by a five and one-half mill share

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[1]William B. Cudlip, "Michigan", Bank Tax Symposium, Committee on State Legislation, American Bankers' Association, New York, 1950, p. 63.

tax on capital account, or \$2.78 million. Total revenue would therefore have been \$3.59 million. In the same year (1951) Michigan banks showed a net profit before federal taxes of \$47.7 million.[1] The conclusion is that business tax levies would have resulted in a tax burden of 7.5 percent of net income before federal taxes. Assuming that earnings have kept pace with deposits and share values, 7.5 percent of net income is approximately the business tax burden now carried by state and national banks in Michigan.

Payment of the capital account tax on national bank shares has been contested by the Michigan National Bank of Detroit on the grounds that the "other moneyed capital" provision of Section 5219 of the Banking Act of 1863 has been violated.[2] The claim made is that shares of national banks in Michigan are assessed at a higher rate than upon other moneyed capital coming into competition with the business of national banks. It was noted earlier[3] that "other moneyed capital" includes not only money invested in banking but investments of individuals in securities and other evidences of indebtedness that normally enter into the business of

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[1] Data on Income, Taxes and Capital Accounts, F.D.I.C., as compiled in the Michigan Tax Survey, 1952, Table 23, p. 60.

[2] Source - Michigan Department of Revenue.

[3] p. 108.

banking. If the law is successfully contested the state will be left with the alternative of taxing shares at a lower rate with consequent loss of revenue or levying an excise tax measured by bank earnings. Cudlip (1950) speaking for Michigan bankers feels that this would result in a heavier financial burden for banks.[1]

Theory of Bank Taxation

A large percentage of the assets of banks is in the form of intangible or representative property. In theory, the principle of a lower tax rate for intangible property than for real property has been supported by economists since intangible property is generally considered to be representative property--representative of real property--and equal rates could result in excessive taxation. Welch (1934) says that "Except the (bank assets) tax be upon the <u>business</u> of banking rather than an ordinary property tax, ... exemptions should be extended to all such securities in the hands of financial institutions."[2] This principle has been followed in taxing bank deposits at the low rate of one twenty-fifth of one percent of their face value. Whether it is a business tax or not is a matter of intent. The law provides that the tax initially be paid by the bank. In very few cases does

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[1] See p. 124.

[2] Welch, *Op. cit.*, p. 77.

the bank pass the deposit tax directly on to the depositor. The intangibles tax on the capital account of banks is more clearly a business tax since it was enacted as a substitute measure for the corporation franchise tax in 1952.

The disadvantages of book value (or capital account) taxation have been frequently extolled in the literature of economics. In the first place, book value may be altered considerably by charging off real estate and losses on loans making assessment difficult. Secondly, book value does not represent earning power. There is, however, one advantage to this type of tax in that it may be used to complement a dividends tax and reach undivided profits.

The principal advantage of the intangibles tax on deposits from the fiscal point of view is expediency. It is collected at source and produces a sizeable amount of revenue. An inducement is offered to banks to assume this tax by adopting a special low rate of one twenty-fifth of one percent of face value. Certain inequities are apparent in this method of taxation. In the first place, derivative deposits are taxed at the same rate as primary deposits. This results in excessive multiple taxation. The second criticism is that the amount of deposits bears only an indirect relationship to ability-to-pay.

There are other methods of bank taxation employed by states. They are (1) a tax on, or according to, net income, (2) a share tax at general property tax rates, and (3) a tax on dividends. History has shown that the taxation of bank shares at general property tax rates leaves much to be desired. The problem evolves around difficulty of assessment, double taxation and inequality of tax burden.

Michigan experienced a tax on bank share dividends under the Intangibles Tax Act prior to 1953. Dividends may or may not be a satisfactory measure of ability-to-pay depending on the individual bank's policy with regard to distribution of profit. A recent study shows that the undistributed profits for all banks amounted to 53.3 percent of net income after taxes in 1950.[1] A tax on dividends if not used in conjunction with a tax on undistributed profit encourages an increase in surplus accounts and permits savings to escape taxation where bank stock is closely held and stockholders are recipients of large incomes.

One advantage of the dividends tax is that it provides a more stable revenue than a tax on or according to net income due to the efforts of corporations to stabilize dividends by alternately adding to or deducting from surplus. States without an income tax on corporations have been reluctant to adopt the dividends tax since it meant abandoning the share tax in accordance with limitations set forth in Section 5219 for

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[1] U. S. Department of Commerce, National Income, 1951 Ed., pp. 171, 175.

national banks.

A lower limit was set on the Michigan dividends tax. Simply expressed, the law stated that the tax shall be three and one-half percent of income, or one-tenth of one percent of face, par, or contributed value. It is readily apparent that this latter base,--face or contributed value--will seldom bear any relation to what the stock is worth particularly after a corporation has been in business any length of time. When earned surplus is omitted from the tax base business policies concerning the distribution of corporate income are affected.

The advantages of a net income tax for financial corporations have been described in Chapter V. Section 5219 of the Revised Statutes, however, makes an important distinction between a tax on net income and a tax according to or measured by net income. Both are permissible under the federal statutes, but the tax measured by net income permits taxation of what would otherwise be tax-exempt interest on government bonds. Many states use this second method. Nichols (1950) states that Section 5219 will not be considered violated unless it can be definitely seen that the tax is on receipts and not on gain, or that the definition of net income in the case of national banks is less liberal than in the case of other corporations.[1] A popular and valid

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[1]Philip Nichols, Op. cit., p. 8.

criticism of corporate net income taxes is that exemptions often create inequities in tax burdens. This criticism is avoided under the provision for taxing according to net income and including tax-exempt securities in the tax base.

Comparison of States' Practices

To summarize, Section 5219 of the Revised Statutes of the United States provides four methods by which the several states may tax national banks. They may in addition to taxing the real estate of national banks,

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 certain conditions are complied with. States may also employ the dividends method with either form of income tax.

From 1864 to 1923 the ad valorem share tax was the only method authorized for taxing national banks, and states with few exceptions did not discriminate against their own banks by levying supplemental taxes. Nine states still tax shares at general property tax rates while seventeen states have adopted a special low rate property tax for intangible property (Table 7).

Since 1923 when other methods were authorized by federal statute twelve states have adopted the net income tax on banks, nine states have applied a tax measured by net income and fifteen states have used a tax on dividends in combination with one of the two forms of income tax.

TABLE 7

METHODS USED BY STATES TO TAX NATIONAL BANKS[1]
1948

	Shares		Net Income	Franchise Tax Based On Net Income	Dividends On Shares
	Regular Rate	Low Rate			
Alabama				x	
Arizona				x	x
Arkansas	x				
California			x		x
Colorado				x	x
Connecticut			x		
Delaware		x			
Florida		x			
Georgia		x			
Idaho			x		x
Illinois	x				
Indiana		x			
Iowa		x			
Kansas		x			
Kentucky		x			
Louisiana			x		
Maine		x			
Maryland	x				
Massachusetts			x		x
Michigan		x			
Minnesota			x		x
Mississippi	x				
Missouri				x	x
Montana	x				
Nebraska		x			
Nevada	x				
New Hampshire		x			
New Jersey		x			
New Mexico	x				
New York			x		x
North Carolina		x			
North Dakota				x	
Ohio		x			
Oklahoma			x		x
Oregon				x	x
Pennsylvania		x			
Rhode Island			x		
South Carolina			x		x
South Dakota				x	
Tennessee			x		x
Texas	x				

TABLE 7 CONTINUED

	Shares Regular Rate	Shares Low Rate	Net Income	Franchise Tax Based On Net Income	Dividends On Shares
Utah				x	x
Vermont				x	x
Virginia		x			
Washington			x		
West Virginia		x			
Wisconsin			x		x
Wyoming	x				

[1]Adapted from Tax Systems, Eleventh Edition, Commerce Clearing House, Inc., by H. K. Allen and Constance C. Einhorn, "Taxation of Banks", Report of the Revenue Laws Commission of the State of Illinois, Springfield, 1949, Chapter XII, Table 1, p. 224.

Louisiana "net income tax" is five percent of gross interest earned.

Washington "net income tax" is an adjusted gross income tax.

SUMMARY AND CONCLUSIONS

Summary

In this chapter the historical development of federal restrictions on the taxing of national banks was traced.

With this as a background, the origin and history of Michigan bank taxes was developed emphasizing the influence of federal limitations upon state bank tax legislation.

Present bank taxes in Michigan were described with special attention given to the intangibles tax, its operation, yield and relative tax burden.

Various bank tax bases were evaluated including those presently employed in Michigan and others permitted by federal statute.

Finally, other states' practices were noted illustrating the diversification of taxing methods used.

It was found that:

1. As confirmed by court decisions, states may not tax national banks without the express permission of the Federal government and then only at no higher rate than other moneyed capital coming into competition with the banks.

2. As prescribed in Section 5219 of the Revised Statutes of the United States there are four basic methods allowed for states to tax national banks in addition to an ad valorem tax on real property. These are (1) an ad valorem tax on shares, (2) a tax on shares and dividends, (3) a tax on net income, and (4) a franchise tax measured by net income. A tax on dividends may be used in combination with a tax on or measured by net income.

3. A comparison of states' practices indicates that all prescribed methods are used. The most common practice is to levy an ad valorem tax on bank shares either at property tax rates or at a special low rate.

4. In Michigan, provision is made for collection at source of bank taxes on capital account and on deposits at face value.

5. The tax on deposits is a low rate ad valorem tax based upon the face value of such deposits. For the purpose of evaluation this tax is considered to be a bank tax since collection is at source and little effort is made to collect the tax from depositors.

6. The yield of the intangibles tax paid by Michigan banks in 1951 was $2,388,659. State banks also paid a corporation franchise tax.

7. At 1953 rates the total business tax burden carried by state and national banks in Michigan in 1951 would have been 7.5 percent of net income before federal taxes.

Conclusions

It is the tentative hypothesis of this study that a revision of the present tax system incorporating taxes based upon capacity-to-pay, equalized between types of companies and collected by one central agency can result in greater equality in tax burden and simplified and more efficient administration.

It may be stated at the outset that tax inequality between types of banks does not present nearly as important a problem as inequality between types of insurance companies. There did exist discrimination between state and national banks under the sales tax and corporate franchise tax when this study was begun, but this has been eliminated. What inequality does exist is due to the type of taxes levied rather than to the uniformity of coverage. For example, it has been pointed out that deposit taxes produced approximately seven times as much revenue as share taxes in 1951. Yet banks which perform primarily as trust companies will have few deposits and a lower tax burden. Based on the findings of this chapter it is concluded that only by adopting a franchise tax measured by net income in lieu of all other state taxes on banks doing business in Michigan can the desired equity between taxpayers be accomplished and taxes be based on capacity-to-pay. The adoption of such a tax will also result in simplified administrative and reporting procedures by substituting one base for the present multiple base system.

It is recommended that the tax rate be set at a level compatible with tax burdens borne by other types of financial institutions in Michigan, to be discussed in Chapter VIII.

Authority for the regulation of banks and trust companies is vested in State Banking Department. The collection function is administered by the Michigan Department of Revenue which also administers the collection of other major state taxes. This dual responsibility has resulted in maximum efficiency in administering present taxes.

CHAPTER VII

TAXATION OF BUILDING AND LOAN ASSOCIATIONS IN MICHIGAN

Introduction

Building and loan associations are located in every state and present an unusual problem in the field of state taxation.[1] They have grown tremendously in size and importance as savings institutions in recent years and thus have come into competition with savings banks and savings departments of commercial banks in this field. In 1947, of nearly nine billion dollars saved, 13.5 percent was placed in building and loan associations.[2] They are also in direct competition with banks and insurance companies in the real estate loan business. In 1949 there were 69 such institutions in Michigan with total assets of approximately $320 million.[3] Some indication of their rapid growth is illustrated in Table 8.

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[1]The term "building and loan association" shall be used in this chapter wherever reference is made to building and loan associations, savings and loan associations, building and homestead associations, and cooperative banks.

[2]Unpublished report, Grant A. Longenecker, Executive Manager, Michigan Savings and Loan League, October 1, 1949, p. 1 (Addendum A).

[3]Boehmler, Op. cit., p. 12-12.

TABLE 8

GROWTH OF BUILDING AND LOAN ASSOCIATIONS IN MICHIGAN(1)

Year	Assets	Number of Associations
1910	$ 18,124,731	63
1915	27,696,545	65
1920	50,976,796	75
1925	96,302,276	90
1930	167,199,813	67
1949	319,923,688	69

(1)Data from 1910-1930 from Irving B. Rich, "Michigan", History of Building and Loan in the United States, p. 444, Table 1; and data for 1949 from unpublished report compiled by Grant A. Longenecker, Executive Manager, Michigan Savings and Loan League.

This table shows that assets of Michigan building and loan associations approximately doubled between the years 1930 and 1949 while the number of associations remained at a fairly constant level.

Building and loan associations operate under a dual system of charters similar to the system for banks. Associations are either federally chartered or state chartered. Approximately one-fourth, or 1,500, of the 6,000 building and loan associations in the nation are federally chartered.[1] In Michigan this ratio is somewhat higher with 33 of the 69 associations having federal charters, or 48 percent.[2]

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[1]Boehmler, Op. cit., p. 12-11.

[2]Longenecker, Loc. cit.

Federal building and loan associations have depositors' accounts insured with the Federal Savings and Loan Insurance Corporation up to a maximum amount of $5,000 per member savings account. They also have membership in the Federal Home Loan Bank, designed to provide a reserve fund in the event of heavy withdrawals of savings from any association which is a member.

A state chartered building and loan association on the other hand, may elect to become a member of the Federal Home Loan Bank. If it does so it has the further option of insuring members' accounts with the Federal Savings and Loan Insurance Corporation by paying the required premium. Neither of these affiliations are compulsory for state chartered associations. However, 25 of the 36 Michigan associations are now members of the Federal Home Loan Bank and 14 have purchased share insurance from the Federal Savings and Loan Insurance Corporation.[1]

In the case of either federal or state charters the governmental authority that grants the charter to the institution also supervises it. This involves an annual examination of accounts and loan security and of compliance with the code or charter governing the association.

The handling of savings is done in much the same manner

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[1] Longenecker, Loc. cit.

as with the savings department of a commercial bank or a savings bank. However, depositors are considered shareholders and the earnings of the institution accrue to them in the form of dividends. Policy is determined by the board of directors elected at an annual meeting of the shareholders. Professional management and a staff trained in the operation of a savings institution are engaged to conduct the day-to-day affairs of the association. Earnings accrue to shareholders through the expedient of investing their shares in mortgage loans and other investments.

The problem of taxing building and loan associations is a difficult issue in most state legislatures. The issue hinges on the mutuality of such associations and the sociological aspects of the type of service which they perform.

Historical Development

The first Michigan building and loan association was organized in Jackson in 1868 as the Germania Savings and Loan Association No. 1.[1] This organization as well as others formed during the 1880's was of the terminating plan type. They were organized to provide the members with funds for building purposes. When the original purpose had been fulfilled the association was dissolved. However, the practice used by many associations, including Germania, was to

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[1] Irving B. Rich, "Michigan", History of Building and Loan in the United States, Chicago, 1931.

reorganize with a new name or number each time the existing bonds matured.

By 1890 a serial type organization was being adopted by building and loan associations to eliminate the waste of repeated reorganizations. The method employed was to issue new series of bonds at regular intervals of three or six months so that there were always unmatured bonds and the association could exist indefinitely.

The first Michigan law applicable to building and loan associations was passed in 1887. These organizations were defined as:

> "... any association or corporation heretofore or hereafter organized or incorporated under any building and loan association law for the purpose of acquiring, building, and improving homesteads, removing incumberances therefrom, accumulating money to be loaned to its members or as hereinafter provided, or assisting its members to accumulate and invest their savings, and which association accumulates the funds thus loaned or otherwise invested, in part, through the issuance or sale of its own stock or shares."[1]

This definition has remained unaltered in the statutes since 1887. The act also provided special tax exemptions:

> "The shares held by any member of any such association incorporated under the provisions of this act, and all mortgages or other securities held by such associations, shall be exempted from all municipal or other tax under the laws of this state."[2]

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[1] Act 50, P.A. 1887, Sec. 1.

[2] *Ibid.*, Sec. 17.

The constitutionality of this provision was upheld by the courts in the case of National Loan and Investment Company v. Detroit (136 Mich. 451,452). In this case the courts found that:

> "Legislature has powers to exempt from taxation the stock and mortgages of building and loan associations; the object of the law is sufficiently expressed in the title, and this section is not repealed by the general tax laws."

At the end of 1896, Governor Rich who had been hampered through two terms of office by large treasury deficits urged the levy of a tax upon building and loan associations.[1] No action was taken however and in 1911 a mortgage tax levied at the rate of fifty cents for each $100 of the remaining principal debt secured by a mortgage on property located in Michigan applied to banks but exempted building and loan associations.[2]

In 1921 an annual fee of one-quarter mill upon each dollar of its paid-in capital and legal reserve was levied on each state chartered building and loan association.[3] This was a specific tax for the privilege of exercising its franchise and transacting its business in Michigan and thus did not violate or repeal the tax exemption previously

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[1]Hedrick, Op. cit., p. 70.

[2]Act 91, P.A. 1911.

[3]Act 85, P.A. 1921, Sec. 4a.

mentioned. Shares, mortgages and securities of building and loan associations remained exempt from any form of ad valorem property taxation.

The 1921 Act provided for an annual fee of two and one-half mills upon each dollar of paid-up capital and surplus for corporations other than building and loan associations. This fee increased to three and one-half mills in 1951[1], and four mills in 1952[2], but the rate for Michigan building and loan associations remained at one-quarter mill per dollar of paid-in capital and legal reserve. Federal associations were not taxed.

The tax exemption on member shares in building and loan associations remained effective until 1939 when such shares became taxable under the Intangible Tax Act.[3] This was valid inasmuch as the new act provided for a specific tax upon the "ownership" of intangible personal property and not an ad valorem tax on shares. The rate was established at six percent of income derived but not less than one-tenth of one percent nor more than three-tenths of one percent of face or par value. The rate for non-income producing intangibles was set at one-tenth of one percent of face, par or contributed value. An exemption of $3,000 of share value was permitted

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[1]Act 277, P.A. 1951.

[2]Act 183, P.A. 1952.

[3]Act 301, P.A. 1939.

for each taxpayer. Building and loan associations as contrasted with their shareholders were exempt from payment of the tax on the ownership of intangible personal property.

This law was amended in 1945 eliminating the $3,000 exemption and providing for a fixed rate of one twenty-fifth of one percent on paid-in shares in building and loan associations, the same rate as for deposits in banks.[1] Associations were given the option of paying the tax in behalf of their shareholders. In all but a few cases this was done.

Present Michigan Practice

In summary of the above it may be stated that a state chartered building and loan association operating in Michigan pays two taxes to the state. The first is the annual corporation privilege fee of one-quarter mill per dollar of paid-in capital and legal reserve. The second is the intangible personal property tax in behalf of its shareholders at the rate of one twenty-fifth of one percent of paid-in membership shares. Federal associations pay only the intangibles tax although federal law permits taxation of these associations under the corporation franchise tax at the same rate as similar state institutions.[2] All building and loan associations are subject to the general property tax on their real

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[1]Act 165, P.A. 1945.

[2]Title 12, Fed. Code Ann. Par. 1464(h).

estate and tangible personal property.

Taxes are remitted by building and loan associations in the following manner (1) the annual corporation franchise tax is paid to the Secretary of State, (2) the intangible personal property tax is paid to the Department of Revenue.

Revenues produced by the annual corporation franchise tax on state chartered building and loan associations have increased slightly in the past few years from $21,118 in 1945 to $27,667 in 1951.[1] Intangibles tax collections from state and federally chartered associations have grown from $70,026[2] to $130,711[3] in the same period of time. The additional revenue from these taxes was largely the result of the growth in the volume of deposits by shareholders.

The tax burden borne by building and loan associations in Michigan is illustrated in Table 9. Data in this table indicates that building and loan associations carry a lighter tax burden than banks, discussed in Chapter VI. It also emphasizes the discrepancy in tax burdens borne by federal and state chartered institutions.

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[1] Financial Report of the State of Michigan, Auditor General, Lansing, Michigan, 1945, 1951.

[2] Figure obtained from State of Michigan, Department of Revenue.

[3] Michigan Tax Survey, 1952, Table 42, p. 92.

TABLE 9

TAX BURDEN OF BUILDING AND LOAN ASSOCIATIONS(1)
Michigan - 1948

		Federal	State	Total
1.	Number of Associations	32	38	70
2.	Net Income	$4,360,150	$3,464,377	$7,824,527
3.	Corporate Franchise Tax	--	27,405	27,405
4.	Percent above tax to net income	--	0.8	0.3
5.	Intangibles Tax (est.)	59,438	42,530	101,968
6.	Percent above tax to net income	1.3	1.2	1.3
7.	Total Taxes (Items 3 and 5)	59,438	69,935	129,373
8.	Percent total taxes to net income	1.3	2.0	1.7

(1) Sources of data are as follows:

Net Income (Federal) - Statement of Operation - Michigan Associations for year ending December 31, 1948, FHLB, Indianapolis.

Net Income (State) - Report on B & L Association, Secretary of State, 1948.

Corporate Franchise Tax - Financial Report of the State of Michigan, Auditor General, Lansing, Michigan, 1948.

Intangibles Tax - Estimate based on one twenty-fifth of one percent of share values.

Other States' Practices

The practices of the various states in taxing building and loan associations differ widely. A quotation from Welch may serve to illustrate the problem of interpreting state tax statutes.[1]

> "Any attempt to tabulate the taxable status of building and loan associations in the forty-eight states involves one in a task of great magnitude. Besides the difficulty of distinguishing between taxes and fees, one is confronted with a host of poorly drafted statutes, conflicting laws, and vague applications of general tax statutes. ... Even more difficult to interpret are the statutes which make no specific mention of the taxation of building associations."

An examination of the comparison compiled by Dr. Welch, however, indicates that the tax systems of other states are replete with exemptions and low rates for building and loan associations. The most common form of tax found is a tax on various assets at very low rates.

Theory of Building and Loan Taxation

Since their inception, building and loan associations have received special tax consideration or immunity under Federal and many state tax laws by virtue of their claim to being mutual, non-profit institutions organized to promote thrift and to permit poor people to own homes. This thinking has been perpetuated by building and loan associations and

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[1]Welch, Op. cit., p. 199.

has been effective in preventing adjustment of tax rates with competing firms.

The point of view that building and loan associations perform a unique service to society has also been propounded by the courts. In an early case it was stated:

> "The primary purpose of these organizations is to encourage people of limited means to procure homes and to make it possible for them to build their homes, secured by their stock and real estate."[1]

A year later there appeared to be some question as to the reality of benefits derived in the following court findings:

> "Building and loan associations are peculiar institutions and from some real or imaginary benefit that they are supposed to afford the poorer classes of society, are frequently given exceptional advantages over other corporations and private persons such as immunity from taxation and usury laws."[2]

In 1904 it became evident that the courts' stand on tax measures was based on precedent and not a thorough examination of the issues involved:

> "The law gives special favors to such associations as these. It permits them to charge high rates of interest and to escape the payment of taxes, - privileges denied to banks and other similar

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[1] Myers v. Alpena Loan and Building Association, 117 Mich. 389,392. (1898).

[2] Phelps v. American Saving and Loan Association, 121 Mich. 343,354. (1899).

> institutions. This is upon the theory that the poorer classes may be able to obtain homes."[1]

The special benefit to home owners so frequently referred to may have been present in the earliest types of building and loan associations. Shareholders in these institutions loaned money to themselves and only for the express purpose of building or improving their homes or removing encumberances from existing homes. The plan made possible the pooling of resources of people of limited means in a mutual type of arrangement.

There are now two classes of shareholders--those who borrow and those who do not. Loans are made for purposes other than home building and improvement, and rates are adjusted when possible to reflect maximum profit for the association. State chartered building and loan associations in Michigan had total assets valued at $171 million in 1944. Of this amount $107 million or 62.7 percent was in mortgage loans and real estate contracts. $51.4 million or thirty percent was in non-real estate investments.[2] Of the mortgage loans, many were made on owned homes to be used for purposes other than improvement.

Building and loan associations under present-day methods

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[1] Stoddard v. Saginaw Building and Loan Association, 138 Mich. 73,79. (1904).

[2] The Economic Almanac, 1946-1947, p. 416. Source: Federal Reserve.

of operation may no longer be classified as mutual, non-profit organizations and there is little justification for believing that lower income groups benefit materially by financing their homes through these associations rather than banks or insurance companies.

There is a further argument that is often advanced by associations supporting the special privilege theory. It is that building and loan associations promote thrift, the implication being that this is a sound economic policy and that a tax on such associations will discourage savings. This would be difficult to prove or disprove. An increase in taxes could conceivably result in increased loan rates, reduced dividends, or streamlining of operations. If the effect is a reduction in dividends to shareholders there probably would be little reduction in volume of savings unless the tax discriminated against building and loan associations in which case savings would shift to institutions which offered a higher rate of return. There is little likelihood of such a shift occurring with a moderate increase in taxes since the average dividend paid by state chartered Michigan building and loan associations in 1949 was 2.8 percent[1] while savings banks paid no more than two percent on deposits and commercial

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[1]Report on Building and Loan and Savings and Loan Associations, Michigan Department of State, Lansing, Michigan, 1949, pp. 9-44 incl.

banks generally paid none and often charged depositors for services. The total volume of savings is dependent upon many more factors than the expected rate of return; factors such as availability of consumer goods, government price restrictions, individual desires, and real income levels. In general, taxes reduce the amount of money available for savings. Government utilization of tax proceeds may however increase investment opportunities and raise income levels, thereby encouraging savings.

SUMMARY AND CONCLUSIONS

Summary

In this chapter the size, nature of operation, and types of charters of Michigan building and loan associations have been described.

The historical development of the tax system for these associations was traced.

The present tax system was outlined noting taxes levied, tax bases and rates, methods of remitting, revenues produced, and tax burdens.

Finally, arguments advanced by building and loan associations supporting the special tax privilege theory were analyzed and evaluated.

It was found that:

1. The volume of assets and savings has increased materially in the past few years and that building and loan associations now compete vigorously with savings banks and savings departments for the savings of individuals. They also compete with banks and insurance companies for real estate loans.

2. A dual system of charters exists with state chartered associations being extended the privileges of federally chartered institutions such as membership in the Federal Home Loan Bank and share insurance in the Federal Savings and Loan Insurance Corporation by paying the necessary fees and premiums.

3. Depositors are considered shareholders and elect a board of directors to determine policy. Earnings, called dividends, accrue to the shareholders through the investment of their shares in mortgage loans, land contracts and non-real estate loans.

4. The first building and loan association law in Michigan was passed in 1887 defining the purpose and nature of such associations and exempting shares, securities and mortgages from taxation. The latter provision succeeded in keeping building and loan association shares off the general property tax rolls.

5. The first state tax on building and loan associations was levied in 1921,--a specific tax on paid-in capital and legal reserves at a special low rate. This was the annual corporation privilege fee. Federally chartered associations were not taxed.

6. The intangibles tax on shares was added in 1939. This was not considered a tax on building and loan associations until the law was amended in 1945 providing collection at source and eliminating exemptions. The rate of tax on such institutions is the same as for bank deposits. Building and loan associations are exempt from taxation on all other intangible property which they hold.

7. All associations operating in Michigan are under the supervision of the Department of State. Examination of federally chartered associations are made jointly by state and federal auditors. Reports are required of member associations by the regional office of the Federal Home Loan Bank. Corporate franchise taxes are remitted to the Secretary of State. Intangibles taxes are paid to the Department of Revenue.

8. The state tax burden imposed on federal associations in Michigan in 1948 was 1.3 percent of net income. State chartered associations carried a tax burden of two percent. The average for all associations was 1.7 percent.

9. There is no uniformity in other states' practices in taxing building and loan associations. The most common practice is to tax one or more of the various assets at a very low rate.

10. Building and loan associations are no longer mutual, non-profit organizations.

11. The claim that such associations promote thrift and permit poor people to own homes has been over-emphasized in the light of present practices of building and loan associations.

Conclusions

As stated earlier, it is the tentative hypothesis of this study that a revision of the present tax system incorporating taxes based upon capacity-to-pay, equalized between types of companies and collected by one central agency can result in greater equality in tax burden and simplified and more efficient administration.

It has been pointed out that inequalities of tax burden do exist between state and federal associations in Michigan and between building and loan associations and other types of financial institutions. To extend coverage and increase rates of present taxes is not an acceptable solution to the problem of inequality since these taxes do not meet the criteria of a good business tax as defined in Chapter IV. A franchise tax measured by net income has been evaluated in previous chapters as well as the corporate franchise tax, the intangibles tax, and tax practices employed by other states with the conclusion that a franchise tax measured by net income best meets the requirements of a business tax on financial institutions. This is true also of building and loan associations.

Building and loan associations in Michigan carry approximately one-fourth as much state tax burden as banks. To equalize tax loads at the bank rate would result in increased revenue to the state. Equitable rates for a financial institution tax system will be discussed in Chapter VIII.

The efficiency of the tax collection function is impaired by having each tax collected by a different state agency. This may be eliminated by having all taxes collected by one agency such as the Michigan Department of Revenue.

CHAPTER VIII

SUMMARY AND PROPOSALS

Evidence has been compiled in the foregoing chapters to prove that:

1. inequities of tax burden exist between financial institutions of various types within the Michigan tax system,

2. the taxation of financial institutions bears no direct relation to capacity-to-pay as measured by net income and,

3. the administration of the tax system for financial institutions is complex and inefficient.

The findings of this study relating to the above points may now be summarized.

It has been seen that financial institutions have throughout their history been considered a special category of business for tax purposes. Insurance companies and building and loan associations have claimed immunity or special tax privilege by virtue of the service which they perform, the classes of people which they serve, or the type of business organization under which they operate. Banks have found refuge in the tax restrictions imposed by the Federal government to prevent discrimination against national banks by the states in which they are located. The result, as indicated in Chapter I, has been that financial institutions now carry a proportionately lighter share of the tax burden than do non-financial businesses.

Of more significance to this study is the fact that tax discrimination exists between financial institutions competing in identical fields. It was found that all three major institutions treated in this study are in direct competition for savings and mortgage loans. However, the state tax burden measured by net income ranges from approximately 0.2 percent for insurance companies to 7.3 percent for banks, with building and loan associations paying 1.7 percent. The low rate for insurance companies is influenced to some extent by the fact that gross premiums taxes paid to other states for outstate business written are not reported. It has been further found that tax burden discrepancies arise between insurance carriers and between state chartered and federal building and loan associations.

In the past, expediency has been the guiding force in determining what business taxes shall be added to the Michigan tax structure. This is exemplified in the tax system for financial institutions. There are four dissimilar specific taxes in this system (see Chapter IV) none of which are uniformly applicable to all financial institutions. The base for each tax is different and none meet the requirements of a business tax based on capacity-to-pay as measured by net income.

An adjunct to the multiple-tax system for financial institutions is the diversification of responsibility for administering and collecting the taxes. There has been no proof that efficiency is not best served by the Department of Insurance supervising insurance companies, the Savings and Loan branch of the Department of State supervising building and loan associations, and the State Banking Department overseeing the operations of banks. However, it has been shown that efficiency of administration and economy result when the tax collection function is centralized in one agency. At present the annual corporate franchise tax on state chartered building and loan associations is collected by the Department of State, insurance taxes are collected by the Department of Insurance, and the intangibles tax is collected by the Department of Revenue. It was found that of these agencies, the Department of Revenue was best equipped to perform the function of tax collection. Complexity and inefficiency of tax administration result also from tax exemptions and special tax rates.

It is proposed that these problems be corrected through a major revision of the tax system. Two methods of accomplishing this, permitting more equitable tax burden, higher revenues, and more efficient administration are outlined in the following paragraphs.

The first plan proposed is to adopt a tax system incorporating a business franchise tax measured by net income as reported to the Federal government, levied at a uniform rate, in lieu of the annual corporate franchise tax, the

intangibles tax, the domestic insurance company privilege fee and the business receipts tax (due to terminate in March, 1955), the authority for the collection of such tax to be vested in the Michigan Department of Revenue. This tax would be applicable to national as well as state banks, as provided in Section 5219 of the Federal Statutes, and has the advantage of reaching otherwise tax-exempt bank securities.

As has been stated in Chapter II the ambiguity of the taxing article of the Michigan Constitution of 1908 introduces the uncertainty that a tax not hitherto imposed in Michigan may be found to be unconstitutional. Such is true in the case of imposing a franchise tax based upon corporate net income. A careful investigation of the legality of a Michigan franchise tax measured by net income has been made by Buckley (1950) with the following findings:[1]

1. An income tax may be said to be so different in form, nature, and purpose from the real property tax as to fall completely outside the provisions of the uniformity clause.

2. Income is taxed under a provision of the intangibles tax and this provision is held valid. The tax is classified as a "specific" tax.

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[1] Frederick J. Buckley, State Income Taxes: Analysis of Constitutional Problems and Statutory Provisions in Michigan and Selected States, unpublished report, sponsored by the Michigan Department of Revenue and the Institute of Public Administration, University of Michigan, 1950, pp. 37.

3. "It is well established that a state may impose a nondiscriminatory tax on net income derived from transactions in interstate commerce as well as from other sources without violating the commerce clause of the federal constitution."[1]

4. "An allocation formula must have some logical relation to the production of income within the state in order not to be in conflict with the due process clause of the federal constitution. To this end the state legislatures have devised various allocation formulas which have in general been held constitutional."

5. "Both the federal district court and the state supreme court have ruled that a franchise tax is valid under the constitution and statutes of Michigan."[2]

6. On the question of basing a state income tax on corporate net income as reported to the federal government: "... a state is free to adopt portions of a federal law insofar as it incorporates by reference existing law but any attempt to adopt prospective changes or amendments to the law made by the Congress is an unconstitutional delegation of power."

7. "In the following states the corporation income tax is linked to some extent with the federal law: New York, Connecticut, Massachusetts, Pennsylvania, Rhode Island, Tennessee, Vermont, Idaho, and Kentucky," although no state ties into the federal law completely.

The rate of a business franchise net income tax for Michigan cannot be proposed at this point since non-financial

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[1] Op. cit., p. 32.

[2] Op. cit., p. 32. Cases cited are: Republic Acceptance Corporation v. DeLand, 275 Fed. 632 (1921); Union Steam Pump Sales Company v. Secretary of State, 216 Mich., 261; N.W. 353 (1921).

enterprises are not within the scope of this study. It is recommended, however, that the minimum rate considered be seven percent of net income which is approximately equal to the state tax burden carried by banks. This rate is the highest of those paid by financial institutions and would permit greater equality of tax burden between banks, insurance companies and building and loan associations with a consequent increase in revenue produced by the last two institutions named.

In 1948 thirty-two states and the District of Columbia levied taxes measured by corporate net income. Of this number, twenty-eight employed uniform rates, the rates ranging from two to eight percent of net income.[1] The average rate for these states was above four percent with most states levying other types of corporation taxes in addition to the net income tax.

Evidence presented in this study has shown that mutual organizations are not inherently different from corporations in mode of operation and realization of profit. It is therefore suggested that in setting up the formula for deductions from gross income to determine net income the burden of proof

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[1]Report prepared by United States Treasury Department, Division of Tax Research, as published in Governor's Taxation Message, delivered by Governor G. Mennen Williams at a joint convention of the Michigan Legislature, February 2, 1949.

of mutuality be the responsibility of the organization claiming it.

Administratively there are many advantages to adopting this proposed tax system. The tax collection function would be greatly simplified. As a result of reducing the number of taxes and employing a uniform tax rate greater specialization would be possible with resulting economies. The Department of State and Department of Insurance would be relieved of tax collection duties, thereby reducing wasteful duplication of effort. In adopting this system however the problem of administering a net income tax on insurance companies arises. It has been shown that the question of reserves and determination of net income is difficult but with proper accounting procedures and reporting does not present an insurmountable barrier to adopting a net income tax.

The actual revenue received from state tax levies on insurance companies, banks, and building and loan associations in 1948 was $2,640,204 (1) (refer to Table 6) or 3.6 percent of net income. A seven percent franchise tax on net income would have produced in that year approximately $5,060,000. Assuming that earnings have increased in proportion to deposits and capital values in the years 1948-54 the franchise tax proposed above is capable of producing materially greater revenue than is produced by existing taxes on financial institutions.

(1) OMITTING GROSS PREMIUMS TAX ON FOREIGN COMPANIES

In view of the opposition which was accorded the corporate franchise tax program proposed by Governor Williams in 1949 and the natural reluctance of state legislatures to relinquish known sources of revenue for untried sources, an alternate proposal will be set forth. Recommendations will be made for reducing inefficiencies and inequities in present taxes and administrative machinery.

The taxation of financial institutions has received considerable attention since this study was undertaken. Two new taxes have been added in lieu of the corporate franchise tax on state banks and domestic insurance companies eliminating inequality of tax burden between state and national banks, and lessening the inequality of burden between corporate and mutual domestic insurance companies in this area of taxation. A trend toward centralization of the tax collection function was begun with the transference of responsibility for collecting delinquent taxes to the Michigan Department of Revenue.

From the nature of the changes that have been made it appears that two problems of taxing financial institutions have been recognized. Resulting action has been taken toward centralizing the tax collection function and eliminating tax discrimination within groups. Nothing that has been done however indicates that tax loads are to be equalized between banks, insurance companies, and building and loan associations or that corporate franchise excise taxes are to be replaced by francise taxes measured by net income.

It has been noted that "specific" taxes are now levied equally upon state and national banks. These taxes are administered by the Michigan Department of Revenue. The business tax burden borne by Michigan banks is approximately equal to 7.3 percent of net income for all banks in Michigan. This rate is higher than for insurance companies but lower than for non-financial businesses. In 1951, Michigan ranked twenty-fifth among the states in the amount of total state and local tax burden on insured commercial banks measured by net income.[1] The tax system for Michigan banks appears therefore to have much to recommend it--centralized tax administration, equality of tax burden between state and national banks and, a normal tax load in comparison to other states.

Previous chapters have indicated that little justification exists for discriminating between banks, which pay over seven percent of net income in business tax levies, and insurance companies or building and loan associations which pay considerably less. The method of taxing banks in Michigan therefore offers a pattern for taxing the other two named institutions if a franchise tax based upon net income is not to be adopted.

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[1] Michigan Tax Survey - 1952, Table 23.

State chartered building and loan associations in Michigan now pay the annual corporate franchise tax at the rate of one-quarter mill per dollar of paid-in capital and legal reserve for the privilege of exercising a franchise and doing business in Michigan. Federal statute permits federally chartered associations to be taxed in a like manner but this is not done.

Both state and federal associations assume payment for members of the intangibles tax of one twenty-fifth of one percent on paid-in shares. This rate is equivalent to the rate levied on bank deposits.

As a result of the above taxes the tax burden on building and loan associations in Michigan in 1948 was equivalent to approximately 1.3 percent of the net income of federal associations and 2.0 percent of the net income of state chartered associations.

The corporate franchise tax on state associations is paid to the Secretary of State and the intangibles tax is paid to the Michigan Department of Revenue, as in the case of banks.

In order to equalize rates between federal and state associations it is recommended that an intangibles tax be levied on the paid-in capital and legal reserves of building and loan associations in lieu of the corporate franchise tax. Based on 1948 figures this tax would have had to be levied at the rate of 1.7 mills per dollar of paid-in capital and legal reserve to have resulted in a tax burden of seven percent of net income when combined with the intangibles tax on member shares. This action would result in equalized rates between state and federal associations, equalized burdens between banks and building and loan associations, centralization of tax collection functions (since the Michigan Department of Revenue is the authorized agency for collecting intangibles taxes) and increased revenues amounting to approximately $418,000 in one year.

Domestic insurance companies now pay an annual privilege fee to Michigan of five mills per dollar of paid-up capital, if any, surplus, and unassigned funds. In addition they pay retaliatory fees in some cases to other states for outstate insurance written. No figures are available on the amount of retaliatory fees paid. Foreign insurance companies pay a gross premiums tax to Michigan on the premiums written in this state. The rate for fire, marine, and automobile insurance companies is three percent. The rate for all other companies is two percent.

It has been established that unlike banks, insurance companies are not protected by the federal government and the state taxation of such companies is left to the discretion of the various states. There is therefore a lack of uniformity in the taxation of insurance companies. Because of the interstate nature of insurance business this diversity of taxes has created an intergovernmental problem of sizeable proportions. Each state dictates its own tax policies. Prior to 1944 more than one-half of the forty-eight states taxed foreign insurance companies at a higher rate than domestic companies. Approximately the same number of states adopted a retaliatory provision penalizing foreign companies.[1]

With the advent of the Southeastern Underwriters' case (1944) eighteen states equalized rates between foreign and domestic companies and thirteen states repealed their retaliatory provisions. Michigan did neither. As of 1945 there were only ten states including Michigan which did not impose a gross premiums tax on domestic companies at as high a rate as on foreign companies. The average rates imposed by taxing states were as follows:

Life	- 2.16 %
Fire and marine	- 2.21 %
Casualty, surety, accident and health	- 2.23 %

Since the average state and local tax burden on insurance companies in the United States in 1945 was 5.5 per-cent and Michigan taxed domestic companies at a far lower rate than foreign companies it is apparent that the burden on Michigan companies is not only lower than on banks and other financial institutions but is lower than on insurance companies of other states as well.

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[1]See p. 73.

One measure may be suggested for increasing the efficiency of the taxation of insurance companies and reducing discrimination in tax burdens. This is to adopt a two percent gross premiums tax on foreign and domestic companies in lieu of the domestic insurance company privilege fee. This would represent the average rate imposed by all states, equalize rates between fire and marine and other types of carriers, eliminate the discrimination between mutual and corporate domestic insurance companies, reduce the number of taxes and rates, and alleviate the discrepancy in tax burdens imposed on insurance companies and banks in Michigan. It is proposed that this tax be administered by the Michigan Department of Revenue in order to centralize the tax collection function and to correlate tax information.

It has been noted that a gross premiums tax at foreign company rates levied in lieu of the corporate franchise tax on domestic insurance companies in 1945 would have resulted in increased revenue of approximately one million dollars.

No proposal for revising the tax system would be complete without appraising the adaptability of the recently enacted business receipts tax as a possible measure for taxing financial institutions. This "emergency" tax was adopted in 1953 to provide revenue for balancing the budget of the General Fund and is due to expire in 1955. It provides for a levy of four mills per dollar on the adjusted receipts or income (over $10,000) of all activities, incorporated or unincorporated, operated for gain, benefit or advantage. Banks, building and loan associations, insurance companies and intangible personal property subject to the intangible tax are exempt. Excluded from gross receipts are wages and salaries received by an employee, proceeds from the sale of capital assets, and amounts used to repay debts. Deductions which are allowable to gross receipts in determining adjusted receipts are the greater of (1) fifty percent of gross receipts or, (2) the sum of itemized deductions which include taxes, materials purchased from vendor who is subject to the business receipts tax, amounts paid for interest and rents, cash discounts, and returned goods. An allocation formula is provided for taxing activities engaged in multistate business.

A comprehensive study of the Michigan business receipts tax has been made by Firmin (1953) in which he states that "the deductibility of various charges is justified on the ground that the particular expenditure (see above) does not constitute part of the "value added" by the taxpayer."[1] Thus, the intent of the law is apparently to impose a "value added" tax. Firmin adds further:

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[1] Peter A. Firmin, "The Michigan Business Receipts Tax", Michigan Business Report No. 24, Bureau of Business Research, University of Michigan, Ann Arbor, 1953, pp. 149.

> "... the Business Receipts Tax is not merely another gross receipts tax with certain deductions allowed by statute. Its basis is not gross receipts, but adjusted receipts as defined in the statute. It differs from the many varieties of sales taxes both general and specific, that are imposed by many states, in that it is neither a transactions tax nor a tax imposed upon the consumer either by implication or by specification in the statute. Neither is the Business Receipts Tax a quasi-net income tax measure. Only if the deductions permitted by the statute were equal in amount to costs and expenses, including cost of sales and all other expenses related to the business activity, would the tax be a net income tax. ... Perhaps the most significant point of dissimilarity, however, is that the Business Receipts Tax, like a gross receipts tax, is assessed even in cases where there is no net income, i.e., where the results of the business activity have resulted in a loss."

The theoretical reason for granting tax immunity to financial institutions in general is not known. There has been a strong reluctance however, as evidenced by the removal of intangible property from the scope of the general property tax to tax intangibles at more than moderate rates since the property which they represent is also taxed. The same principle has carried over to businesses dealing in intangibles. It may be said however that value is added through the activity of financial institutions by investing money at interest for others and performing unique services. This is evidenced by the fact that the sale of such services produces profit or net income to the taxpayer. Considered as a business tax and not as an extension to the general property tax there appears to be little justification for exempting financial institutions from the scope of the Michigan business receipts tax.

There is a valid reason for exempting banks from this tax however. National banks may be taxed only according to certain methods prescribed by the National Banking Act of 1863 as amended. The business receipts tax (value added) is not one of these methods and is therefore prohibited. The levy of such a tax on state banks would result in discrimination in tax burden between state and national banks in Michigan.

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APPENDIX

APPENDIX A

TABLE 10

MICHIGAN GENERAL PROPERTY TAX TRENDS[1]
1900-1951

	Assessed Valuation	Total Tax Levies	State Levy	Tax Rate Per $1,000 Assessed Valuation
1900	1,317,450,028	20,380,533	2,908,802	15.47
1901	1,335,109,918	23,350,404	3,835,888	17.49
1902	1,418,251,858	23,476,734	2,669,875	16.55
1903	1,537,355,738	25,999,018	4,003,255	16.91
1904	1,529,969,350	25,891,584	2,958,005	16.92
1905	1,574,422,770	27,402,199	3,871,080	17.40
1906	1,598,935,606	26,330,650	3,384,065	16.47
1907	1,654,371,892	29,153,970	4,886,742	17.62
1908	1,648,671,411	29,689,332	4,194,334	18.01
1909	1,687,155,697	34,879,093	5,929,305	20.67
1910	1,739,652,458	35,710,510	4,730,417	20.53
1911	1,898,057,358	39,315,699	6,523,013	20.71
1912	2,078,694,409	43,242,968	5,451,853	20.80
1913	2,345,695,709	50,569,766	8,591,275	21.56
1914	2,765,439,636	50,811,961	6,130,120	18.37
1915	2,968,236,813	60,596,921	9,509,462	20.42
1916	3,625,142,971	61,815,004	7,221,843	17.05
1917	4,027,364,717	73,612,698	9,610,533	18.28
1918	4,218,781,678	85,132,657	9,109,653	20.18
1919	4,503,980,981	110,776,106	17,432,512	24.60
1920	5,319,702,886	140,438,983	17,379,244	26.40
1921	5,483,535,114	158,388,567	20,452,380	28.88
1922	5,622,913,389	160,222,825	17,305,384	28.49
1923	5,933,301,772	170,094,458	16,000,000	28.67
1924	6,470,614,422	178,756,981	14,500,000	27.63
1925	6,954,262,131	191,660,043	17,800,000	27.56
1926	7,558,802,199	220,002,608	17,800,000	29.11
1927	7,896,374,986	242,158,137	24,500,000	30.67
1928	8,168,069,289	248,511,398	20,500,000	30.42
1929	8,362,913,114	264,611,569	29,500,000	31.64
1930	8,460,234,945	266,777,083	29,500,000	31.53
1931	7,854,628,979	254,180,521	29,000,000	32.36
1932	6,603,821,037	216,580,601	23,487,979	32.80
1933	5,821,072,389	159,459,990	3,500,000	27.39
1934	5,685,263,349	158,030,435	3,500,000	27.79

TABLE 10 CONTINUED

	Assessed Valuation	Total Tax Levies	State Levy	Tax Rate Per $1,000 Assessed Valuation
1935	5,652,288,256	147,493,887	--	26.09
1936	5,720,274,670	146,301,493	--	25.57
1937	5,912,306,455	154,809,906	--	26.18
1938	6,054,858,530	166,453,538	--	27.49
1939	6,120,089,325	167,296,253	--	27.34
1940	6,028,028,754	166,766,516		27.66
1941	6,268,830,279	170,944,380		27.28
1942	6,623,578,978	183,197,021		27.65
1943	6,825,977,942	187,813,295		27.51
1944	6,956,197,603	192,620,072		27.69
1945	7,187,197,422	205,306,643		27.92
1946	7,557,770,730	232,221,040		29.15
1947	8,463,550,743	247,204,202		27.38
1948	9,139,645,231	286,213,287		29.16
1949	9,729,449,214	329,417,780		31.63
1950	9,940,547,423	342,117,946		32.00
1951	10,704,742,678	375,314,891		32.61

[1]State Tax Commission, Biennial Reports.

APPENDIX B

THE PROVISIONS OF SECTION 5219 OF THE REVISED STATUTES OF THE UNITED STATES

"Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That Section 5219 of the Revised Statutes of the United States be, and the same is hereby, amended so as to read as follows:

"Sec. 5219. 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.

"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." (Act March 25, 1926. C.88;44 Stat. L. 223).