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HISTORY
OF
RAILROAD TAXATION
IN
MICHIGAN

WILBUR O. HEDRICK

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THE HISTORY OF RAILROAD TAXATION IN MICHIGAN

A thesis submitted to the Faculty of the Department of Literature, Science and Arts of the University of Michigan, for the degree of Doctor of Philosophy.

BY

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PREFACE.

The history of railroad taxation in Michigan was prepared by Prof. W. O. Hedrick of the Michigan Agricultural College, upon request of Dr. Henry C. Adams, professor of Political Economy and Finance of the University of Michigan.

The thesis has been printed by the Legislative Reference Department of the Michigan State Library, hoping it may throw light upon existing conditions and perhaps assist in the settlement of questions involved in the taxation of the railroads of Michigan.

MARY C. SPENCER,
State Librarian.

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TABLE OF CONTENTS.

		Page
	Preface	3
	Introduction	7
	CHAPTER ONE.	
	The Capitalization Tax	9
I.	Railroad Development in Michigan	9
II.	General Taxation	12
III.	The Beginnings of Railroad Taxation	13
	CHAPTER TWO.	
	The Tax on Gross Income	21
I.	The "Municipal Aid" Movement	21
II.	Administration and Characteristics of the Tax	23
	1. The Basis of Taxation, Definition of "Gross Income," the Term "Per mile" and Localization of Income	23
	2. The Tax	26
	3. Productivity of the Tax	28
	4. Problems in Administration	30
III.	The Public Attitude Toward the Tax	32
	CHAPTER THREE.	
	The Property Tax on Railroads	34
I.	The "Equal Taxation" Reform	34
II.	The Taxation Law	39
	1. Assessment Provisions	39
	2. The Tax Rate	41
	3. The Board of Assessors	44
	CHAPTER FOUR.	
	The Operation of the Property Tax	45
I.	The Assessment Process	45
II.	Problems of the Rate and of Equalization	50
III.	Results from the Tax	53
	CHAPTER FIVE.	
	The Disposition of the Tax: Summary	57
I.	State Taxation for Local Expenditure	57
II.	Centralized Administration	63
III.	Merits of the Property Tax on Railroads	65
	Bibliography	69
	Index	71

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THE HISTORY OF RAILROAD TAXATION IN MICHIGAN.

INTRODUCTION.

Almost a half score of years have gone by since the extension in Michigan of the property tax to railroads. This achievement resulted from a controversy—known as the "equal taxation" controversy—concerning the merits of the "property" as compared with the "income" methods of railroad taxation which left little unsaid or undone that would show merit or defectiveness in either of these systems. The people of the state indeed underwent a severe educational discipline in matters pertaining to railroad taxation and the taxing law which was enacted should embody, seemingly, the best current intelligence with regard to this kind of legislation.

It is the purpose of this study to examine the nature and the workings of this tax and also the purely financial aspects of the reform from which the new measure originated. The displaced gross income tax will be discussed, principally because it affords a basis for comparisons, and a still earlier tax—the one on securities—will also be noticed in order to show the beginnings of some administrative methods which have been successively applied to all the taxing systems that have been employed by the state. Finally a critical examination will be made into the peculiar disposition of railroad taxes which has always prevailed in this commonwealth.

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CHAPTER ONE.

THE CAPITALIZATION TAX.

I. Railroad Development in Michigan.

The familiar grouping of railroads in Michigan into two classes—one known as the "charter roads," and the other as the "general law roads" —has embarrassed the State with a dual system of railroad taxation from the beginning.

The "charter roads" owe their origin to an early State constitution which forbade incorporation by other than special acts of the legislature. More than forty charters were granted to railroad companies under the provisions of this constitution but of these all save five proved sterile so far as the development of their franchises is concerned. A further distinction of this small group of survivors is that they were the beneficiaries of the internal improvement movement in Michigan—all of them indeed with the exception of one, having been built or promoted by the State.

The history of internal improvements in Michigan has had many narrators and needs but a condensed statement here.*[1] In brief, an internal improvement commission, appointed in 1837, the first year of statehood,*[2] undertook the construction of three railroads across the state—named, in order, the Northern, the Central, and the Southern. Little or no actual accomplishment ensued upon the Northern route, the Central was more than half built, and the Southern more than a third.

This activity of the state was in full harmony with the controlling spirit in neighboring states at this time. It apparently had become settled that improvements of this sort were not to come from the general government and, individual initiative being doubted, state governments everywhere undertook the building of highways, canals and railroads. A further incitement to such enterprise in Michigan arose from the "boom" which the state was undergoing. More land was bought and sold in Michigan in a single year (1836) than during its whole previous history.*[3] The number of inhabitants had increased in three years (1834 to 1837) from 87,278 to 174,575.*[4] The share, too, of the Federal surplus distribution due to the State arrived on the very eve of commencing these improvements and helped to stimulate the movement.

But on the other hand the failure of this internal improvement policy was scarcely doubtful from the first. The widespread financial panic of 1837 antedated by only a year the actual beginnings of railroad building

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*[1]See Miss Keith's "An Historical Sketch of Internal Improvements in Michigan. Mich. Pol. Sci. Pub. Vol. IV.

*[2]Mich. Statutes, 1837, p. 193.

*[3]Adams' R., "Agriculture in Mich." Mich. Pol. Sci. Pub. Vol. III.

*[4]Judge Cooley, "History of Michigan," p. 255.

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by the State. The credit of the State was the resource relied upon to supply the funds for these improvements, but the misplacing of the first loan of five millions of dollars, whereby more than half was lost, and the hesitancy of the state in acknowledging responsibility for these "lost millions" forestalled the further use of credit. Inexperience with every detail of railroad economy took a heavy toll from the builders—such, for instance, as the early use of "strap rails" which soon required replacement at large expense. Sectional controversies over locating the improvements and construction scandals—familiarly known more recently as "graft"—caused legislative inquiries and brought disrepute upon the enterprise.

It was the exhaustion of funds and credit, however, which brought an end to the undertaking. By 1845 no means remained except taxation, and the interest charges alone upon the debt already contracted exceeded by three times the income which had thus far been received by taxation during any one year from the people of the state.*[5] It was well known that taxation for further construction of roads would meet with resistance and the opportunity having arisen in 1846 for the sale of the Central and the Southern both were in that year disposed of to chartered companies which were designated by the names which the roads had previously borne.

The roads with the special charters have easily maintained leadership among their kind in the state—the advantages of an "early start" having worked incalculably toward this end. They were without rivals during the first decade after their sale by the state, for ten years longer they exceeded in mileage the united mileage of the remainder of the roads in the state and their traffic earnings until 1880 surpassed the aggregate earnings of all of the other roads taken together.

The "general law roads" owe their name to a general law for incorporating railroads, enacted in 1855, since the second constitution which the state adopted proscribed special acts of incorporation except in the cases where incorporation was desired for public purposes. The roads of this group, which now exceed in number and mileage the number and mileage of the one time "charter roads," were given their first great impetus by the land grants from the Federal government. These grants, of which two or three of the long north and south roads were the chief beneficiaries, consisted chiefly of heavily timbered pine lands and were repeatedly renewed and enlarged. Indeed, the land grant history compiled in 1880 and published by the 46th Congress shows that three states only of those which were beneficiaries of this policy were the recipients of larger amounts of this land than was Michigan.*[6]

The building of roads of this class was given a second stimulus when in the late sixties there was a partial relapse of the people of the state into the road-building-at-public-expense mania of the internal improvement period. This new manifestation, through making use of the municipalities in securing the funds for road construction, became known as the "municipal aid" movement and a measure of its intensity is found in the fact that the railroad mileage of the state during the seven years

*[5]This is clearly set forth in the official documents of 1836. The governor's message 1846, p. 22 shows tax receipts of $72,305.23 for the preceding year. The Auditor's Report 1846, p. 6 shows interest charges of $240,000 annually due from the state.

*[6]Executive Doc. 47 Part IV Forty-sixth Congress, 3rd session, Chap. 20. See too Ringwalt's "Transportation Systems," p. 226.

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prior to 1870, under the stimulus of this movement, was increased by 975 miles, over which not less than sixty-five new companies exercised proprietorship.*[7]

Once again in a later instance simple commercial forces were deemed insufficient to furnish the state with adequate traffic facilities. In 1891 a law was enacted which exempted from taxation all roads which should be built in the upper peninsula and in the northern part of the lower.*[8] This familiar device for promoting railroad construction had been hitherto frequently used in the state as an encouragement to particular lines and now, when given more general application, proved immediately effective though it was unable to weather unrepealed the anti-railroad feeling which the equal taxation reform a few years later engendered.

The growth in mileage of the "general law" roads and of business importance on the part of the "charter" lines brought out plainly in the early eighties the undesirability of continuing longer the especial privileges and exemptions—particularly taxation exemptions—which distinguished these two kinds of properties and steps were taken at this time to abridge or amend the charters. The Lake Shore and Michigan Southern was the company selected for attack and in 1877 a joint resolution by the legislature directed the railroad commissioner "to provide for the collection of any specific taxes due from this line" even if litigation must be employed.*[9] The following year a suit was commenced as a result of this resolution, the state contending that the company was the result of a consolidation between a Michigan company and an outside company under the general railroad law of the state and therefore was amenable to the taxing provisions of this law.*[10] The case was tried before the supreme court and a decision adverse to the government was rendered. A similar charge was made against the Detroit, Grand Haven and Milwaukee by a senate committee in 1883,*[11] and the suit which followed before the supreme court for the dissolution of the charter of this road proved also unavailing to the state.*[12] Once again the legitimizing controversies of this last road were re-experienced. This was in 1905-6 when the validity of its early charter was again declared—in this instance by both the West Michigan Federal court and also by the United States supreme court.*[13]

In the "equal taxation" agitation of the late nineties but little less stress was laid upon the desirability of repealing these charters than was laid upon the enactment of the new taxing law itself since such a law would produce grave inequalities if these chartered roads were to be exempt from its action. The charters themselves, it was found, furnished a means for their own extinction through the provision which each contained, save that of the Detroit, Grand Haven and Milwaukee, that after thirty years the state might "alter, repeal or amend the same," "provided that said company shall be compensated for all damages sustained by reason of such alteration, amendment or repeal."*[14] Under this provision and following the advice of a special commission consisting of the

*[7]See statutes 1863, '65, '67, '69 for names of companies. Auditor's Rep. 1870 for mileage.
*[8]Statutes 1891, p. 218.
*[9]Joint Res. No. 17 Statutes 1877.
*[10]State Treas. vs. Auditor Gen'l 46 Mich. Rep., p. 224.
*[11]Sen. Jour. 1883, p. 808.
*[12]Att'y Gen'l vs. Joy, 55 Mich. Rep. p. 94.
*[13]Mich. Tax cases 201 U. S. Rep. p. 293.
*[14]Sec. 39 of Mich. Central Charter (1846).

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railroad commissioner, state treasurer and secretary of state a special session of the legislature in 1900 rescinded the charters and arranged by permissive legislation for the litigation which should settle the amount of damages for which compensation should be awarded.

The state has pursued a singularly favorable policy towards the railroads. Not only have these properties enjoyed the specific gratuities which have been mentioned—state construction and aid, land grants, municipal aid, tax exemptions, etc.—but they have had wide freedom from public regulation. At the time when the adjoining states, under the influence of the "Granger movement," were reducing traffic rates to the limits of railroad endurance, Michigan remained satisfied with the mere assertion of regulative power expressed through an amendment to the state constitution.*[15] Freight rates have indeed at all times until recently, been free from public regulation in this state and the case has not been much otherwise with passenger fares.*[16] The supervisory legislation, too, which the state has enacted from time to time has been invariably of the strictly customary type in its requirements of accident precautions, reports and other details which these laws involve.

II. General Taxation.

The resource from which the expenses of the state government in Michigan have been defrayed in the past have been in the main an apportioned general property tax. This exaction itself has remained fairly uniform throughout the history of the state. Prior to 1850 it was a rated tax and seldom exceeded in amount one and one-half or two per cent as annually provided by statute. In the period which followed the civil war the expenses of government seem to have increased since an elaborate and careful computation made by Auditor Humphrey in 1870 shows a tax of two and one-half per cent for the year 1869*[17] and in recent years as reported by the Board of State Tax Commissioners an impost approximating two per cent has been found necessary.

The annual assessments of property upon which this tax is levied have also shown a fairly stable rate of increase. In 1853 when the State Board of Equalization was established, the taxable property of the state was in one year increased from a few millions of dollars to one hundred and twenty millions, but from this date onward the growth in largeness has been almost uninterrupted, measuring slightly more than a billion and a half at the time of the last assessment.*[18]

In addition to this chief source of revenue, Michigan has always had many various fees and taxes. These have secured more prominence than is usually given to such imposts in other states through being grouped together under the name of "specific taxes," though this name has been used with little scientific precision, unfortunately, since levies so widely dissimilar as dog taxes and fees from incorporations have been classed together as specific taxes. Variation from the common general property type of tax alone would secure apparently until recently for an impost the name of specific tax.*[19]

*[15]Art. XIX "A" Mich. Constitution.
*[16]See Act No. 202 Statutes of 1889.
*[17]Aud. Rep. 1870, p. 54.
*[18]The Aud. Rep. for 1896, p. 309-10 gives the assessed and equalized valuations of property in this state from 1836-1891.
*[19]In 1899 in the case Pingree vs. Aud. Gen'l, the term specific tax received a definition from the Supreme Court which has had the effect of improving the classification of taxes in the Public Reports and other documents of the state.

Besides grouping these miscellaneous taxes in this unusual way the state early in its history began the practice of using the proceeds from the specific taxes for the support of the public schools. The conclusion seems justifiable that it is this especial use to which these taxes have been put which has stamped the name into our fiscal system rather than that an especial partiality has been developed for the specific as compared with the ad valorem levy. The history of these taxes shows at any rate, that immediately upon the development of suitable methods of assessment and collection specific taxes have been invariably discarded and their places have been supplanted by the general property tax.*[20]

The early use of these taxes in Michigan originated through the necessity which the territorial government labored under of securing its revenue from tavern-keepers, ferry-keepers and merchants "because merchants and ferry and tavern-keepers were practically the only people who had ready money with which to pay taxes."*[21] But it is as a levy upon unusual taxables that these exactions have had their greatest use and here especially the individual character of the specific tax has rendered it serviceable, since to extraordinary properties the ad valorem requirements of the general property tax are frequently hard to apply.

Among these taxables, with pronounced individual variation, which have been imposed with a specific tax in Michigan, such as banks, inheritances, mines, and insurance and express companies, railroads have been easily the foremost and the recent transfer of these great properties to the lists of the general property tax has depleted the term "specific tax" in its practical aspects of nearly its whole significance and the famous localism seems now threatened with entire disuse.

III. The Beginnings of Railroad Taxation.

The earliest taxation of railroads in Michigan resulted from the sale of the state built roads to private companies—none of the earlier charters indeed (a score or more) having had any suggestion of taxation among their provisions. In the charters of the road purchasing companies it is provided that

> "the said companies shall pay to the state an annual tax of one-half of one per cent upon the capital stock paid in—until the first day of February, 1851, and thereafter an annual tax of three-fourths of one per cent upon the capital stock paid in—and also upon all loans paid to said company for the purpose of constructing said roads.*[22]

The tax was to be paid to the state treasurer and the taxation of the roads as units was further insured by the terms of the exempting clause "and the property and effects of said company, whether personal, real or mixed, shall, in consideration thereof, be exempt from all and every other tax."

The new tax immediately became the general law tax*[23] too—barring

*[20]Banks, street car companies, mining companies and many others illustrate this fact. "Taxation by an assessed valuation of the property must be the rule, specific taxation the exception, seems an unavoidable conclusion," says Justice Campbell in summing up the relations between the two systems. Wolcott vs. People, 17 Mich., p. 60.

*[21]Schaffner Terr. Tax. Leg. in Mich. p. 27.

*[22]Michigan Central Charter, Statutes 1846. p. 61.

*[23]The same legislature which sold the roads also adopted the revised statutes in 1846. Apparently the terms of the charter provisions regarding taxation of railroads were simply adopted into the revised statutes. Revised statutes, 1846, p. 14.

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the part which applied to bonds—and, since its employment here was meagre owing to the sparseness in number of the roads subject to a general law tax,*[24] i. e., companies organized under the general railroad law of 1855, its application to these roads may well be disposed of at this point. None of the roads of this sort, indeed, had attained much size before the expiration of the tax and the statutory restriction of the impost to capital stock alone and to only *paid in* capital stock and to that only which represented "the proportions of the road actually constructed" caused the proceeds from this capitalization tax, as applied to general law roads, to represent an almost insignificant amount.

The rate of taxation upon these roads was increased in 1861 to one per cent*[25] and in 1869 the base of the levy was enormously enlarged. The legislature of this latter year had succeeded in passing a general law by which municipalities might freely vote "aid" in the building of railroads and, largely, as a sop, seemingly, to the important elements in the state which had opposed the "aid" legislation, it enacted a new taxing law which imposed the one per cent rate

> "upon the capital stock paid in and upon all sums of money, whether arising from net proceeds of such roads, from municipal aid, from sale of land or from other resources which shall from time to time be invested in original construction or stocking or any new construction or stocking."*[26]

An assault like this upon all the sources of railroad capitalization at once could scarcely fail in productiveness and the tax contributions from the general law roads the year following the enactment of this law were approximately three fold greater than the highest payment of any preceding year.*[27] But the measure was of short duration since the legislature which followed the one of 1869 not only repealed the taxing statute but also voted the return to the companies of the surplusages over the usual payments which hitherto had been contributed.*[28]

It is consequently with the charter roads, therefore, that the capitalization tax has had its chief use in Michigan and the relations between this impost and these roads remained almost unchanged for half a century.

The nature of the obligation to the state assumed by the companies with regard to the use of securities for the basis of taxation, and the choice of "three-fourths per cent" as the rate of payment resulted wholly from bargaining. Although, too, the character of these dues was a pivotal question in the sale of the roads to both the state and the companies*[29] no explanation regarding the agreement between these two parties on tax details can any where be found. The authority to which

*[24]A computation in the State Auditor's report for 1871 (page 27) shows a return of $48,849.42 in taxes from the general law roads for the preceding year. But since these were payments made under the all embracing statute of 1869 and much of it was paid back to the roads this amount is in excess of what may be considered legitimate tax receipts. There seems to have been this year forty-three general law companies and 1,000 miles of road.

*[25]Statutes of 1861, p. 126-7.

*[26]Statutes of 1869, p. 262.

*[27]The tax due from railroads in 1869 equalled $176,487.70; in 1870 the amount due was $471,630.71.—Aud. Rep. 1869, p. 56; 1870, p. 71.

*[28]Statutes 1871. Act 106.

*[29]Many years after the sale of the road the representative of the companies in conducting the bargaining—Mr. James Joy—asserted "the Central could not have been sold by the state had it not made its scheme of railroad taxation exactly what it did. See Detroit Free Press, April 17, 1891.

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the roads should be amenable in their payment of taxes seems, indeed, to have provoked more comment in the legislative committee "on sales" than did the railroad attribute which should be taxed and the assignment of these properties to the state exclusively for taxation is explained in the report of this committee as follows—"since the expenditures upon the roads had been from the state treasury it was deemed but just that the proceeds of the tax should accrue exclusively to the state."*[30]

This custom here commenced of making the tax a state tax rather than a local one, though brought about by circumstances rather than through the wise foresight of government, was destined to a greater productiveness of vital results than was any other feature of the law. The free hand which the state government has always had in Michigan in modifying its methods of taxing railroads because there were no local interests to be considered, the specialization of the receipts to the support of schools and the administratively superlative centralized management of the tax are the important issues from this arrangement which are most easily noted.

It was clearly the plan of the authors of this system that their tax should be a levy upon the value of the roads as measured by their costs of construction. This is the distinct inference from the taxing statutes themselves and is also the judgment of contemporary authorities. In the charter, for instance, in which the tax is originally found the provision occurs that the impost shall be upon the stocks and bonds and also upon the "purchase moneys" which the companies paid to the state for the roads. In the last alteration, also, which the tax underwent—the law of 1869—it will be noticed that not only was the levy to be made upon the securities of the companies but it was also to be made "upon all sums of money which shall enter into the construction or stocking of the roads."[31] The tax was frequently passed upon by the supreme court, and, on one of these occasions Judge Campbell explained its nature by the assertion "it was never designed that it" (the tax) "should be lessened by any disaster any more than that it should be increased by any amount of prosperity."*[32] When read with the context, the implication made here is plainly an assertion of the belief that the tax has been fixed by construction costs and was not afterwards subject to change. Even more plainly in the same case Justice Manning declared "it is a tax on what the construction of the road should cost the company."*[32]

The imperfections of such a taxing method are easily discovered. The value of a railroad is very incompletely measured at best by the outlay necessary for its existence. An authority on railroad valuations has recently said "it would be nearer the truth to say that costs of railway properties have nothing to do with their values than to assert that the values of railroad properties are identical with their costs."*[33] But, even had costs of construction proven an adequate measure of values, which in the case of new roads might not have been wholly suppositional, the defectiveness of this tax was confirmed by the use of securities at their par value as the means of measuring costs.

The period, for example, during which the capitalization tax was most widely employed in Michigan was the period of "public aid" in road

*[30]Sen. & H. Doc. 1846, No. 2, p. 6.
*[31]Statutes 1869, p. 262.
*[32]Mich. Rep. Vol. 5, p. 452 and 459.
*[33]Dr. B. H. Meyer, Bull. U. S. Dep. Labor and Commerce, No. 21, p. 17.

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building. Private capital was nowhere—except in certain special instances—willing to take the risks nor in sufficient amounts to furnish the sinews for adequate extensions of these great utilities. Under these circumstances, "land grants," subsidies voted by municipalities, and public and individual gifts are found everywhere among the resources of road construction which the railroad companies employed and none of these would necessarily affect the number of shares of stock, i. e., the base upon which the capitalization tax was levied. An exact representation of the proportions of the resources which had entered into the general law roads prior to 1870 may indeed be compiled from the road reports of this year and the discrepancies in the capitalization method of measuring costs are at once plainly apparent. The compilation is as follows and shows the amounts invested in the construction and stocking of roads opened for use prior to 1870:*[34]

Capital stock	$9,127,067 46
Earnings of roads	2,457,471 88
Municipal aid	378,550 00
Proceeds of sales of lands	168,883 26
Loans	12,807,571 67
From other sources	816,795 12

The tax on stocks and bonds valued at par is apparently the simplest of methods by which a government may collect revenues from corporations. The administration of such a tax to be successful requires only the enumeration of the securities and the imposition upon each of the taxing rate. A method of such simplicity, too, must have been one of especial satisfactoriness to an undeveloped state government which had undertaken to tax railroads as entireties though no suitable administrative machinery for this purpose had been at this time any where developed. Some difficulties were experienced with the law, however, from the first. These resulted from the statutory provisions that the stock must be "paid up" and that loans must be those "used in construction," and these hindrances were added to when later the issues of stocks were no longer kept within strict investmental limits but became speculative and when bonds came to assume many forms.

The new company, for example, which purchased the Southern in 1849 issued several kinds of bonds, also common stock, bonus stock, and later, stock dividends. The dispute between the state and the road as to which of these were amenable to taxation lasted fully twenty-five years and was passed upon several times by the supreme court. Briefly summarized the decisions of the court were as follows: First, that stocks issued as dividends and as bonuses should be considered "paid up;" second, bonds which had been dishonestly disposed of so that nothing was received by the company, were twice held to be taxable, but upon the final decision a reversal prevailed; third, loans unwisely used—in one instance in the building of a ship which was lost and, in another, the making of a loan, which was never repaid, to a neighboring road—were declared subject to taxation.*[35] Against both of these last two decisions dissenting opinions were filed showing discord among the jurists as to the components of capital stock "paid up" and "bonds used in construction."

*[34]Report of Railroad Corporations, Aud. Rep., 1870, p. XIV and XV.
*[35]4 Mich. Rep. (1856), p. 398; 9 Mich. Rep. (1862), p. 448; 46 Mich. Rep. (1881), p. 193.

Conflicting interpretations of this sort and the reversal of the first settlement by subsequent decisions discovers the practical difficulties of assessing taxable securities, at least, as conditioned by the Michigan statute, and removes "simplicity" from among the assured attributes of this tax.

The localization of the taxable securities which were amenable to the state in the case of interstate roads was another problem which quickly proved troublesome. Michigan had maintained a peculiar attitude of insularity with regard to railroads during the first two or three decades of their existence. The early publicly owned roads had been located to a large extent in the interests of particular localities, and, further than serving to connect one great lake with another, had completely ignored natural trade routes. But the interests of the public in the respect of having railroad accommodations were not lost sight of in transferring these properties to private hands, and it was sought to perpetuate them as Michigan roads after their sale had taken place by obliging the purchasing companies to accept the exact routes which had been assigned to the original roads.

The early proposal then of the Central's owners to continue their line to Chicago met with a vigorous condemnatory memorial from the legislature*[36] as did also the actual adoption of Toledo as its eastern terminus by the Southern instead of the commonwealth's choice, the city of Monroe.*[37] Ultimately the interests of trade prevailed in each instance and the charters to both the Central and the Southern were so amended in 1855 as to permit each the desired foreign connection.*[38]

The division of the securities of these roads into portions which should represent the parts of the systems within the state and the parts without now became the problem of taxation. The legal aspects of the matter were soon settled since in response to a petition from the roads to the legislature "that the capital stock expended within the state shall alone be liable for the state tax"*[39] Attorney General Hale offered the opinion that only this part *could* be taxed "and the reports of the roads as to their proportions must be accepted."*[40] Under the easy conditions thus laid down which allowed the roads to designate the proportions of their securities upon which they wished to pay taxes, no further difficulties, of course, were experienced with the localization problem.

The machinery for administering the tax was of the simplest possible type. The roads were to furnish the state auditor each year with reports to which certain officers of the company took oath and from which the auditor certified to the state treasurer the amount of the tax to be collected. The levy was essentially a self-imposed one since no means were provided any where by which the state might ascertain the veracity of these reports and their truthfulness seems never to have been officially questioned.

The early reports were sharply restricted in their scope to such matters as would be useful for assessment purposes. A few details concerning stocks and indebtedness, the number of men employed, the amounts of dividends, length of mileage and the names of officers sufficed to answer the questions upon which the state sought information. The

*[36]Sen. Doc. 1851. No. 17.
*[37]House Doc. 1850. No. 10.
*[38]Statutes 1855, p. 300 and 304; also Stat. 1848, p. 276.
*[39]Sen. Doc. 1850. No. 17, p. 42.
*[40]Sen. Doc. 1859. Doc. 3, p. 4.

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demands of "publicity" were still to be felt before these reports should become the voluminous documents with which we are now familiar. No responsive warmth favorable to reports was aroused in the roads however, in return for the extreme moderation of the state in its inquiries.

> "When the present auditor general took charge of the department," says Auditor Humphrey in 1868, "a number of the railroad and railway companies in the state, although they had been in operation for years, had never made a report upon which the tax could be assessed, and to that time had escaped all taxation. A reference to the report from this department for the year 1866 shows that but twelve of the twenty-two railroad and railway companies had reported as required by law."*[41]

The remissnesses on the part of the roads which have just been described had not been overlooked however by legislation, since as early as 1853 a law had been passed which enabled the auditor general to "ascertain the amount of specific tax of any corporation failing to make the required report, as appears from their last report."*[42] The inadequacy of this remedy was not slow in discovering itself. The companies simply ignored their obligations with regard to reports and made none of any sort whatsoever and the extent of their perverseness in this respect is measured in part by the complaint just noticed from Auditor Humphrey.

The publication of road reports for general distribution was commenced by Auditor Humphrey in 1868 and the advertising opportunities, which were thus presented to the companies through this official display of their resources to the public stirred many of them seemingly to greater readiness in supplying data. But it was through an enactment of 1872 that the cure was finally provided which put an end to the neglect of reports. By the provisions of this law the auditor was authorized to "estimate the amount of tax due from and payable by such corporations from the best information he may be able to obtain whenever such corporation shall refuse or neglect to make report as required by law."*[43]

The tax rate upon the charter roads—one-half of one per cent the first five years and three-fourths thereafter—was apparently a triumph for the companies in their bargaining with the state. It is indeed small in comparison with the one and six-tenths per cent which constituted the tax for general purposes upon all other property which the same legislature imposed that sold the roads to the companies. The discrepancy, however, between the rates which the legislature of 1846 voted upon roads and the one voted upon general property appears less striking when it is considered that the former were assessed at approximately a full valuation at this time while general property was greatly undervalued.*[44]

A pronounced disparity in the taxation of the two kinds of property so far as the rate is concerned is not apparent indeed for many years. A careful computation which was made by Auditor Humphrey in 1870, for example, shows that the expenses of government necessitated a tax of only three-fourths of one per cent upon the actual value

*[41]Aud. Rep. 1868, p. 13.
*[42]Stat. 1853, Act 22.
*[43]Stat. 1872, Act 57.
*[44]Aud. Rep. 1846. A tabulation found here shows a decrease in the assessed valuation of the state from $43,000,000 in 1838 to $29,000,000 at the date of tabulation.

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of the property in the state while as a result of the under-assessment of this property the actual rate was two and one-half per cent, thus demonstrating that the roads were not under-taxed at this time.*[45] But on the other hand, by the end of the century, and after the state tax commission had thoroughly satisfied itself as to the real value of the state's taxable property, a tax which was approximately one and one-half per cent was ascertained to be the average rate to which ordinary property was liable.*[46] Manifestly the growth in the rate of taxation upon general property had by this time outstripped the rate to which the charter roads would have been liable had they continued under the capitalization tax until this time and a disparity which was equal to the doubling of the impost upon ordinary property as compared with that upon the roads could no longer be ignored.

The productiveness of the capitalization tax in its application to the charter roads was obviously capable of expansion only as the number of taxable securities increased since the tax rate was unalterable. The numbers of these securities grew from period to period with the growth in value of the roads though the full harvest of revenues from these increases was denied the state through administrative neglect in enforcing the tax rigorously from year to year. The tax itself exercised apparently little or no deterrent effect upon the growth in numbers of these securities since two of the roads—the Central and the Southern—allowed themselves capitalizations which, in spite of the tax, were approximately equal by the end of the century to the valuations assigned them by the "great appraisal."*[47] It was therefore largely the leanness of the rate which caused these roads to contribute so meagerly to the support of government as to arouse against them by the end of the century a popular uprising—contributions which were indeed only as one to three when the revenues developed by this capitalization tax during its last years are compared with the revenues from the ad valorem property tax during its first.*[48]

The short comings of the capitalization tax both in principle and in administration are not explainable as acts of forbearance on the part of the state by which the roads should receive a sort of public bounty—the explanation which is usually employed to account for laxity in the early taxation of railroads. On the contrary, an avowed reason from the legislative committee on sales for disposing of the roads was the revenue which should be derived thereafter from these properties by taxation. The expectations of the times in regard to the productiveness of this tax seems in fact to have bordered the fanciful. "With the application of three-fourths of one per cent in 1851" estimates Governor Ransom, "there will be afforded a sum sufficient to meet all necessary expenses of the state government leaving the whole amount of the state tax to be applied in the payment of the public debt.*[49]

*[45]Auditor's Rep. 1870, p. 54.

*[46]Rep. of State Tax Com. 1902, p. 69.

*[47]The stocks and bonds upon which the Central would have paid taxes in 1900 had capitalization continued the equivalent of costs equalled $26,042,123.57; the Southern $6,232,480. See reports of the Central and Southern for 1900 for construction costs. The official valuation in 1901 equalled for the Central $26,764,263, for the Southern $6,992,965. See Cooley-Adams Appraisal, Report of State Tax Com. 1900, p. 180.

*[48]See table on page 55.

*[49]Message 1849, p. 3.

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That a half century was allowed to elapse without the improvement of a tax of such an unsatisfactory character is most immediately accounted for by the apparently indestructible character of the special charters. The disposition of these charters was an insolvable problem for many years. The state lacked, also, specialized administrative officers who should devote themselves to the consideration and management of railroad taxes and who should acquaint the public with information concerning this form of taxation. But, far more than for any other reason, save perhaps, inherent weakness in principle, the general insignificance of the capitalization tax, which we have described, resulted directly from public indifference during the period of this tax to the whole question of railroad taxation.

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CHAPTER TWO.

THE GROSS INCOME TAX.

The new impost*[1] which supplanted the capitalization tax used gross incomes from the railroads as its base. It became immediately operative upon all the general law roads—forty or more—within the state, and eventually the charter roads too accepted its provisions.

I. The "Municipal Aid" Movement.

The new taxing law was clearly an outcome from a violent agitation concerning railroads which had disturbed the state for more than a decade. The movement resembled in many ways the earlier "internal improvement" activity and has been not inaptly called the "municipal aid mania."*[2] The building of many new railroads, the establishment of the office of railroad commissioner*[3] and the adoption of an amendment to the state constitution asserting full public authority in determining railroad rates*[4] were still other important issues from this excitement.

Railroad "promoting" by township, village and city governments is the characteristic from which the agitation derived its name, and the two legislatures of 1865 and '67 received petitions for enabling acts with which aid might be given to roads involving scores of municipalities. The culmination of opportunities of this sort to the municipalities, however, was apparently reached in 1869, when, through the adoption of a general law, all these minor political divisions were empowered to give aid at will.

The road building impulse itself sprang naturally from the business revival which followed the civil war and, especially in Michigan, from the traffic demands of the newly developed lumbering industry which was so soon to dominate the industries of the state. The strength of the impulse is suggested by the assertion from Governor Baldwin in his message of 1873, that

> "railroads have unquestionably been the most important causes which have led to the development of the state within the last few years. On the first day of January in 1869, Michigan had 1,199 miles of railway in operation, since that date 1,808 miles had been completed, or 150 per cent more than the entire length constructed during the entire previous history of the state."*[5]

*[1]Mich. Statutes 1871, p. 354.

*[2]The character of this mania may be roughly estimated by the enthusiasm with which railroad projects were everywhere received. Lansing, the state capital, in one year (1869) was the focus of six railroads all of them receiving "municipal aid," while two more had been granted articles to build to Lansing and still another was being promoted. Lansing was already the terminus of a "land grant" road and of another built by "municipal aid." No trade resources could possibly have been found in an inland city of 6,500 inhabitants to warrant the need of eleven railroads and public excitement must probably be credited with such a large prospective supply. (See State Republican, Oct. 14, 1869.)

*[3]Laws 1873, p. 91.

*[4]Laws of 1870, p. 13.

*[5]Governor Baldwin's message 1873, p. 40.

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Gratifying as results like these must have been to the friends of the commonwealth the debts, which the municipalities had necessarily incurred in supporting the movement stirred enmity to "municipal aid" from the beginning. Governor Crapo, the state executive during four years of this period, vetoed more than twenty enabling acts voted by the legislature of 1867 and condemned in many vigorous messages the whole "aid" policy.*[6] Some of the large city newspapers were unvarying too in their hostility, and finally, in 1870, a decision from the supreme court was rendered which declared the complete illegality of any debts contracted by the municipalities in the furtherance of the municipal aid policy*[7] and the whole activity was seen at last to be at an end when a special session of the legislature was unsuccessful in annulling the court's decision by securing the adoption of a constitutional amendment which had been proposed.*[8]

The fiscal obligations of the railroads were not neglected during this great ferment. The same legislature which enacted the municipal aid law provided also that the capitalization tax of one per cent should be extended to all receipts from this "aid," to receipts from land bounties and to receipts of all other kinds which should be employed in road construction.*[9] A tax of this sort was too exorbitant to remain long upon the statute books, especially since it was opposed uniformly by the general law roads to all of which it applied. The annulment of the "municipal aid" legislation by the supreme court left the roads with no important exceptional resources of any sort and it was plain that many of the newer roads would be injuriously affected unless a remedy could be provided against this heavy tax. The legislature, therefore, which convened the year following the famous decision not only repealed the burdensome tax but returned to the companies all collections made under its provisions,*[10] and, finally, commenced a new order of railroad taxation by enacting the income tax.

This change, although of great moment, was effected without extended comment either within the legislative chambers or by the newspapers of the day—the newness and unimportance from a traditional standpoint of the general law roads, to which alone the new tax applied, furnishing the clearest explanation of this absence of interest in a new method of taxation.

The new law resulted in a distinct lowering of the payments made by the railroads and this effect, when noticed, was complained of by Auditor General Humphrey as follows, "the act of 1871 for the incorporation of railroads changed the basis of taxation for such companies. The result has been a falling off in receipts from such taxes."*[11] That such an outcome, however, was distasteful to the people of the state can not easily be proven. The state was still illy provided with railroads and the capitalization tax had been a levy upon railroad construction. Under the new law there was to be no contribution from the roads until a traffic had been developed—a contingent basis of taxation to the companies which offered loop holes for escape as compared with the exacting

*[6]Veto Messages, Sen. Jour. 1867, p. 750.
*[7]Detroit, Lansing and Northern R. R. Co. vs. Salem Township, 20 Michigan Rep. p. 450.
*[8]Laws of 1870. Special Session.
*[9]Laws of 1869, p. 262.
*[10]Laws of 1871, Act 106.
*[11]Aud. Rep. 1872, p. 21.

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character of the taxing base which was furnished by the hard and fast construction costs.

The tax was re-enacted three times during its history and was subjected to many amendments. In 1891 the leveling spirit in the legislature attempted the extension of the income tax to the charter roads.*[12] The feasibility of this procedure had been the theme of several legislative inquiries, the occasion of repeated litigation in the supreme court, and the achievement of this result was destined finally to become one of the chief incentives to the repeal of the special charters. Eventually all of these especially privileged roads complied with the legislation of 1891,*[13] so far as it pertained to taxation, but the equivocal character of this compliance is shown by the immediate return of most of them to the provisions of their charters when by the enactment of the Merriman law of 1897*[14] a higher rate of taxation upon incomes was established.

II. Administration and Characteristics of the Tax.

The new taxing law provided that "every company" (general law company)

> "shall pay a tax computed in the following manner, viz: upon the gross receipts to the amount of three thousand dollars per mile of road regularly operated (or less) one and one-half per cent; upon the receipts in excess of three thousand dollars and less than six thousand dollars, per mile, two per cent and upon the gross income equal to or in excess of six thousand dollars per mile, three per cent."

The local taxation of roads also was forbidden in this law by the usual exempting phrase,

> "which tax shall be in lieu of all other taxes upon the property of the company—except real property not necessary for carrying on the ordinary operations or franchises of the roads."

1. The Bases of Taxation; Definition of Terms; Localization of Income.

This separation of the railroad property which is functional from that which is merely collateral as provided for in the clause last quoted, is a familiar requirement in most schemes of state administered railroad taxation, but its practical achievement in Michigan seems at no time to have been an easy task. The phraseology which describes these two species of railroad property though carefully elaborated in the second enactment of the taxing law, has indeed required frequent interpretations from the courts in order to settle the jurisdictions to which individual pieces of railroad property were liable.*[15]

To the railroads the delimitation which should be applied might indeed work double taxation owing to the careless interpretation, which from the first was given in Michigan, to the term "gross income." The new taxing base was here without the usual qualifications found in statutes of similar nature in other states of "gross income from transportation" or "gross income from operation," and, as administered by taxing officials and construed by the courts, "gross income" from all

*[12] Mich. Statutes 1891, Act No. 133.
*[13] Laws 1891, Act 133.
*[14] Law 1897, p. 293.
*[15] G. R. & I. R. R. vs. City of Grand Rapids. 137 Mich. Rep., p. 587.

sources in Michigan became subject to taxation. Under conditions of this sort collateral property might be taxed locally and its rental or sale proceeds again contribute to the support of government through entering into the gross income of the proprietary road. A taxing base so illy determined became the source of much confusion to administrative officials when in the later history of the law the policy was adopted of applying the impost vigorously and Commissioner Osborn complains in his report of 1898

> "that if the plan of taxing upon gross income is perpetuated it would be wise on the part of the legislature to further particularize and declare just what is defined and incorporated by the term "gross income."*[16]

The fatal defect, theoretically at least, in income taxes generally, of not distinguishing the sources from which taxable income is derived might easily have been avoided it would seem in the case of taxpayers with such an uniform source of revenue as have railroads if a closer definition of the term "gross income" had prevailed. Nevertheless, the term was understood in Michigan to include receipts of all sorts, and tax administrators uniformly applied the impost to incomes from sources so diverse as those from building rentals, car ferries, mines, elevators, stone quarries and warehouses as well as to those from railroad operations.*[17] The first requisite of a good income tax,—namely, that it be levied upon incomes which are naturally homogeneous was in this way violated by the Michigan statute.

The importance of the term "per mile" in measuring the number and the quality of the units of income to which the tax should be applied was early recognized. Commissioner Williams complains at length in 1879 of "the serious variations in the reported lengths of some of our older roads."*[18] The Chicago and Northwestern, for instance, insisted, when reporting its income "per mile" in 1881, upon using its entire mileage whether of owned or of rented lines, in Michigan or elsewhere, as the divisior by which to derive from its gross income its taxable income per mile.*[19] The railroad commissioner reports a decrease in taxable income for this road of nearly $3,000 per mile as the result of using so much mileage as a divisor in comparison with the amount used in previous years. The road was clearly in the wrong and subsequently the supreme court established the meaning of the term "per mile" as indicating "the number of miles between the terminals of the road constituting the main line."*[20]

The localization of income from interstate roads for taxation purposes was another administrative task which was sure to present difficulties. The original law of 1871 made no provision respecting this matter, but, with the revision of this statute two years later the rule was legalized which had thus far been practiced as a custom, namely,

> "that when a road lies partly within and partly without this state, there shall be paid such portions of the tax herein imposed as the length of the road within this state bears to the whole length of the operated portion thereof."*[21]

*[16]Mich. R. R. Com. Rep. 1898, p. 34.
*[17]R. R. Com. Rep. 1899, p 10.
*[18]R. R. Com. Rep. 1879, p. 9.
*[19]R. R. Com. Rep. 1881, p. 32.
*[20]Union Depot Co. vs. R. R. Com. 118 Mich. Rep., p. 347.
*[21]Laws of 1873, p. 532.

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Practically applied the administration of this rule required that the total earnings of the interstate roads should be first ascertained. These were then divided in accordance with the proportions of the road which were within Michigan as compared with the proportions which were elsewhere and the share which fell to Michigan was then levied upon.

The problem with regard to interstate roads, was chiefly the legal one as to whether or not this rule of assessment, which involved earnings made in other states, was an interference with the commerce between states over which the national government claimed exclusive jurisdiction. The constitutionality of the Michigan tax was not tested in court until late in its history and then only in part,*[22] but nevertheless, the impost in this state did not wholly escape the influence of this doubtful constitutional status.*[23] The matter was indeed a constantly recurring theme for comment in the reports of the railroad commissioners and the readings of the taxing statute underwent marked changes from time to time in order to secure better conformity with constitutional requirements.

The report of Commissioner Rich in 1890, for instance, advises upon this question of constitutionality that

> "the United States courts as well as a number of state supreme courts have recently decided that in taxing on gross receipts only those receipts can be taxed which are earned on business done wholly within the state. One case now pending against the St. Paul, Minneapolis and Sault Ste. Marie R. R. Co. involves this question and in case it should finally reach the United States supreme court it will undoubtedly be decided as against the state. Substantially the same results can be reached by providing for a board to determine the value of each railroad per mile including its equipments and the gross earnings can be the basis of ascertaining the value of the properties for taxation purposes."*[24]

The new taxing law which issued from the legislative session of the year which followed this report showed fruitage from the commissioner's counsel. The phraseology of the new act had been so worded that the familiar terms of the previous statutes "shall pay an annual tax on the gross receipts of such company," were now supplanted by the expression, "shall pay a specific tax upon the *property* and *business* of such corporation."*[25] The tax, however, which was imposed, was identical in character with the previous ones, gross receipts remained as before the objects upon which the levy was made and the administrative machinery remained essentially unaltered. It is difficult to believe, therefore, although in each subsequent enactment of the law this phrase, "upon the property and business," was scrupulously retained, that the constitutionality of the tax was materially improved by the substitution of the new words. The merely verbal character of the change is further

*[22]Wis. & Mich. R. R. Co. vs. R. R. Com. 191 U. S. Rep., p. 379.

*[23]Accutely suggestive of restrictive consequences was the suit entitled Fargo vs. Mich. (121 U. S. Rep. p. 230) in which were involved seemingly the essential questions which a court would have to decide were the litigation against the tax on railroads instead of that on a fast freight line. The history of this epochal case is briefly as follows: In 1883 the state extended the gross income tax to fast freight lines. One of these resisted the tax as unconstitutional through taxing interstate commerce and endeavored to restrain the state from collecting the tax. The state supreme court denied the restraining order, but the federal supreme court sustained the contention of the company that the tax was unconstitutional.

*[24]R. R. Com. Rep. 1890, p. 37.

*[25]Laws of 1891, p. 217.

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proven by the fact that the real nature of the tax apparently remained unaltered from the view point of the public. The tax seems to have remained in the popular regard as a tax upon gross receipts until the time of its repeal and indeed in the debates and discussions of the equal taxation movement no contention was at any time emphasized that the railroads were taxed upon their *business* and *property*.

An amendment of a more radical nature was made by the legislature of 1893, in which the practice of employing all the earnings of interstate roads in the determination of this mileage income was abandoned. The portion of a road's earnings which came from interstate commerce was to be levied upon under this new act separately from the portion which came from commerce carried on within the state and this first portion was to be proportioned "as the length of road over which interstate business is carried in this state, bears to the entire length of the road over which said interstate business is carried."*[26] In a word upon interstate commerce the train mileage method of proportioning gross receipts was substituted for that of the track mileage. The new rule made the processes of determining the gross receipts of the roads more complicated than ever and apparently operated to reduce the amounts upon which taxes were paid*[27] and the disturbing fact remained, moreover, to those who hoped to find in this amendment an improved constitutional status for the law that earnings made in other states were still involved in the computation of the tax. The incisive criticism is made by Commissioner Wesselius "that the law in thus saying that the tax is then upon state commerce alone denies that two parts constitutes the whole."*[28]

Still another remedy was thought to have been discovered by the legislature of 1891 by which dissatisfaction on the part of either the roads or the state might be mollified (in this way apparently preventing appeals to the courts) through the provision of a permanent arbitration board—the State Board of Railroad Crossings—to which either of the two parties involved in the taxation of interstate commerce should appeal for redress.*[29] The spectre of discord which stirred the legislature was more imaginary than real apparently since nothing of importance has ever developed from this arrangement.

2. *The Tax.*

The tax rate provided by the new system was very complicated and has been aptly described as a "sliding scale" rate. In the terms of the taxing law which prevailed during the first two decades

> "Every company shall pay an annual tax computed in the following manner, viz.: Upon such gross receipts not exceeding four thousand dollars in amount per mile of road operated, two per cent of such gross earnings; upon such gross receipts in excess of four thousand dollars per mile so operated, three per cent thereof."

In practice a provision of this sort necessitated the application to the companies of a variable rate. The units of income per mile earned by a company, which were subject to the lowest rate, would be taxed in the first instance; surplusage of income over the amount per mile which

*[26]Laws of 1893, p. 217.
*[27]R. R. Com. Rep. 1897, p. XII.
*[28]R. R. Com. Rep. 1898.
*[29]Laws of 1891, p. 218.

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was amenable to the lowest rate would then be levied upon with the higher rate.

A tax of this sort offended seriously the time worn canon "that a tax ought to be certain, ought all to be clear and plain to the contributor and to every other person," since no one could possibly tell before hand —especially after the taxing scale became more graduated—the tax rate to which any important road was subject. The rate paid by the Grand Trunk Western, for example, during a period of ten years varied with each year though in the meantime no alteration had taken place in the terms of the law.*[30] Popularly indeed,—so great was the confusion upon this subject,—the tax seems to have been accepted as the mere application of the progressive income principle to the taxing of railroads*[31] although the real situation was far different.

The obvious intention of using a rate of this sort was that of discriminating among roads so that those with larger earnings should pay higher taxes as compared with the poorer or less profitable roads. The commonwealth's uncompleted railroad net furnished at all times marked contrasts in the earning capacities of the different roads due to varying business opportunities, varying stages of completedness or incompletedness and to variations in costs of operation and maintenance, and discriminations of the sort which the law sought to make seem to have been wholly justifiable.

The plan adopted, however, had little merit as an accurate means of measuring this ability to pay. The statute in its desire to accurately discriminate faculty made provision for two refinements upon the simple ordinary income tax, namely, the "per mile" method of grouping incomes and the graduation of the rate and of these the graduated rate is of most significance since it is clear that the mere grouping of income into mileage aggregates would have no consequences if a uniform or flat rate only were imposed. But the selective efficacy of the Michigan rate in discriminating among the roads was neutralized by the application of the first term in the rate scale to the lowest per mileage income groups of all roads alike leaving the higher terms of the scale to be applied to the excess income only of the denser traffic roads. An examination of the tax reports of the railroad commissioners shows that no road ever contributed to the state upon all its income at a rate which would equal the highest term in the scale and that the customary tax rate upon the more profitable roads was the lowest term in the scale plus some fraction of the higher ones.

The faculty measuring device, too, which was used to distinguish the units of income with high taxableness from those with low was so arbitrarily applied as to constitute another defect. The tax paying ability of a unit of gross income is fairly measured by the portion of its whole amount which is net and the expenses which are deducted to procure this net residum are roughly, though customarily measured by the extent of road operated relative to the amount of income procured —in a word by the "per mile" income. This method of measuring the comparative costs of different units of gross income and the consequent residums of net income is employed by the Michigan statute and consequently the net income principle is recognized says ex-Railroad Com-

*[30]R. R. Com. Reports from 1880-1891.
*[31]Seligman Essays in Taxation, p. 158.

missioner Rich, who goes on to explain "because a larger amount of gross income per mile, or a larger amount over expenses must pay a higher rate of taxes."*[32]

But the thoroughgoing application of this method of discovering taxableness was not consistently followed in the Michigan plan. No exemption list for example was allowed, and, although the expenses of some of the poorer roads was greater than their earnings, the requirement of a tax from all was uniformly enforced. It is in the case of the dense traffic roads, however, that the widest departure from the established method takes place. The incomes of these roads, as has been noticed, were grouped for the imposition of more than one of the terms in the rate scale thus presuming—if the principle of measuring ability to pay by net income is rigorously maintained—the existence of several grades of expenses for the same road, when of course, as a matter of fact, the "costs" of these roads were as homogeneous as were those of the poorer roads.

A concrete illustration of the inequitableness of this method in determining taxableness is found in the case of the two roads given below where, with relatively equal earnings in 1897, the first road paid only a third more than the second, though this latter must operate more than twice as much road to obtain its earnings.

Name.	Gross Income.	Taxes Paid.	Milage.*24
Grand Trunk..................................	$2,166,355 26	$64,254 24	224
Chicago & Northwestern Co.....................	2,093,694 60	47,175 13	521.19

3. *Productivity of the Tax.*

The productiveness of a gross income tax grows naturally with the growth in gross receipts to the companies or through an increase in the taxing rate or through some combination of both these factors. In Michigan both the gross receipts and the taxing rate were enlarged during the three decades of this impost. The tax contributions from the companies, when taken grossly (i. e., as including contributions from new roads, improvements in administration, etc.) increased from an average of $107,620.5 per year during the first half decade of the impost's history, to that of $1,082,428.8 per year during its last five year period. The gross receipts under the same conditions and during the same time increased from $17,876,156 to $38,276,098 per year, showing a mere doubling in amount while the growth in taxes as already indicated exhibits fully a nine-fold increase.

Some explanation of this marked augmentation in the amount of the tax receipts developed must be found in the periodic enlargement of the taxing rate which took place during this time although improved efficiency in the administration of the tax was also influential. The exact effect of these enlargements of the rate are not indeed measurable because, through being a variable—a "sliding scale"—rate, the propor-

*[32]Sen. Jour. 1898. Appendix p. 36.

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tions which this rate itself should have, when in actual application to the gross income of any company, was dependent directly upon the amount of this income.

The statutory scales of rates on the other hand may be easily compared and a general notion of their effectiveness may be possibly gathered by an examination of these comparisons. Enlargements, it will be noticed, of the rate scale were the results of heightening the individual rates in each scale and, also, from adding to the number of rates which a scale should include, and changes of both sorts must be compared.

In the law of 1871 as low a rate as one and one-half per cent was levied upon earnings which did not exceed three thousand dollars per mile; two per cent upon surplusage not in excess of six thousand dollars per mile and three per cent for all further surplus.*[33] The lowest rate in the law of 1873 was two per cent leviable upon all earnings equal to or less than four thousand dollars per mile. Surplusage in excess of this amount was amenable to a levy of three per cent.*[34]

Under the law of 1891 no earnings were to be levied upon with a lower rate than two per cent, while some—namely, those from two thousand to four thousand per mile—were to pay two and one-half per cent. For the four thousand and more per mile earnings three rates were made by this law of 1891 instead of the single rate as in the previous law. Surplus earnings over four thousand per mile, which did not exceed six thousand per mile, were levied upon with the old rate of three per cent; those in excess of six thousand but not in excess of eight were levied upon with three and one-half per cent while all other surplusage received a four per cent levy.*[35] The law of 1897 merely raised each one of these last rates by half or a quarter or by one per cent so that they ranged two and one-half, three and one-fourth, four, four and one-half and five per cent respectively in comparison with the rates of the preceding law.*[36]

The disparagement of being an extremely variable tax in the amounts of its proceeds has been widely affirmed against this tax. A study of such fluctuations in the Michigan tax during a period of eighteen years, when the rate remained unchanged and returns from roads newly constructed during this period are disregarded, may be presented as follows:

*[33]Laws of 1871, p. 354.
*[34]Laws of 1873, p. 532.
*[35]Laws of 1891, p. 217.
*[36]Laws of 1897, p. 293.

NOTE.—An easy computation from the railroad commissioner's reports shows that during the first three years in which income per mile is presented (1883-4 and 5) an income of $15.328 per mile developed a tax of $126.66 while during the last three years of the tax the same amount of income would develop a tax of $186.50 per mile. This increase should seemingly be attributed largely to the heightening of the rate which had taken place in the meantime.

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	Amount of railroad taxes Developed.	Amount of increase over previous year.	Amount of decrease over previous year.	Per cent of increase over previous year.	Per cent of decrease over previous year.
1874	$175,463 63				
1875	173,280 60		$2,183 03		.012
1876	165,072 54		8,208 06		.05
1877	169,764 98	$4,692 34		.03	
1878	158,286 53		11,578 45		.07
1879	175,690 95	17,404 12		.11	
1880	288,032 06	112,341 41		.63	
1881	200,174 92		87,857 14		.30½
1882	385,296 54	185,121 54		.92	
1883	389,847 78	4,551 24		.11	
1884	281,693 94		108,153 84		.27
1885	221,727 71		60,171 38		.21
1886	382,522 56	160,794 85		.72	
1887	418,045 84	35,523 38		.09	
1888	404,699 00		13,346 94		.09
1889	435,099 16	30,400 16		.07½	
1890	469,314 77	13,346 94		.08	

A comparison of these receipts shows that there was more than a two fold increase in the annual amounts developed by this tax during the period of eighteen years in question, but that there was no regularity in the rate of increase. The fluctuation upward from 1881 to 1882 is extreme and also another great upward fluctuation is found between the years 1885 and 1886. An extreme downward fluctuation occurs in 1881, so that the charge of variableness when made against this tax seems well sustained.

4. *Problems in Administration.*

The administration of the tax was for a time placed in the hands of the auditor general—the taxation law of 1871 declaring "every company * * * shall pay to the state treasurer on the order of the auditor general an annual tax, etc." This latter official was also to receive the annual reports from the companies and, in case of neglect on their part to make report, or in case of fraudulent or false ones was to assess a penalty. The law of 1873 provided for a railroad commissioner,*[37] who was to receive the reports and in 1879 this official was given the authority to compute the railroad taxes and to enforce the penalties against these companies.*[38]

Useful as the data embodied in the reports from the companies must necessarily be to any system of railroad taxation such data was indispensable to the administration of the gross income tax since an early law provided that the computation of this tax "shall be based upon the report of each company."*[39] The reliableness therefore of reports became fundamental to this tax. The excise indeed seems to have suffered from its excellencies since the same dependence put upon these reports, which commended this tax as being inexpensive—"a self-assessed tax," etc., was also the dependence which caused suspicion that the reports themselves were dishonest and deceptive.

The reports indeed underwent radical changes in character from

*[37]Laws of 1893, p. 91.
*[38]Laws of 1879, p. 41.
*[39]Laws of 1879, p. 41.

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time to time as a result, largely, of the increased importance which they acquired through their relations with this tax. By 1879 the number of separate topics upon which comment was made in a railroad report numbered forty-two—a threefold increase in number over the reports of the capitalization tax period—and the additional privilege had been granted the railroad commissioner of making any further inquiries "relating to the duties of his office" which he might choose to ask.*[40] The subject matter of the reports too had undergone a change since the earlier period because traffic from the standpoints of costs, income, quality, etc., instead of property had now become the subject of interest about which information was desired.

The question of the reliableness or the unreliableness of the reports, though of crucial significance to the justness of the tax, is a question of fact which only the practical administrator is qualified to answer. The conclusions of the railroad commissioners, however, by whom the reports have been received in Michigan, are so widely at variance concerning this matter that they make no certain reply to the investigator.

> "Sworn returns are by no means infallible," says Commissioner Cobb, "and the simplest computations contained in them are found to be incorrect to such an extent that it is unsafe to accept them without verification."*[41] Commissioner Wesselius, also, similarly declares "the earnings reports of many companies have been very unsatisfactory in the past. In some cases the (reported) earnings have been so ludicrously small that the mere presentation of the matter to the railroad companies has caused them voluntarily to make some concessions to the state."*[42]
>
> On the other hand Commissioners Williams and Osborn assert the fullest confidence in the veracity of the reports. Says the former, "the power to prescribe the system of accounts to be used by our railroad corporations and to investigate the books when necessary, leaves little or no reason for irregualities,"*[43] and the latter declares "the checks on the reports of gross income are so numerous as to make them accurate beyond speculation."*[44]

The statutory devices for insuring truthfulness in the reports seem to have been of the typical sort, i. e., the companies must render reports annually, subject to heavy penalties for failure to comply and their methods of account keeping must be prescribed by the commissioner of railroads*[45] and the latter official was fully empowered with the usual warrant for subpoenaing railroad officials, taking testimony under oath and for securing access to railroad properties and records.*[46] The hindrances, therefore, to discovering the actual facts which the reports from the companies should make seem to have been of a practical sort, and, apparently, were fairly insurmountable.

> "It will be seen in the case of interstate roads," says Commissioner Wesselius, "that some of the earnings that properly belong to this state could be easily concealed in such a manner as to make detection almost impossible, and even too, in the purely Michigan

*[40]Laws of 1873, p, 93.
*[41]R. R. Com. Rep. 1874, p. 1.
*[42]R. R. Com. Rep. 1897, p. 39.
*[43]R. R. Com. Rep. 1881, p. 32.
*[44]R. R. Com. Rep. 1900, p. 14.
*[45]Laws of 1881, Act 144.
*[46]Laws of 1873, p. 93.

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> roads concealment of part of the earnings is comparatively easy. The scheme of railroad bookkeeping is so elaborate and intricate, especially in the case of interstate roads, as to preclude the possibility of making an examination of the books which would prove of real value."*47

Nothing, indeed, would seem more improbable than that commissioners already burdened with the many duties which pertain to their office would still be enabled to make the detailed examinations by which the accounts of the roads could be verified. The administration of this tax, too, does not seem, in fact, by any means to have been the chief official task which rested upon the railroad commissioners. An examination of the annual reports made by these officials shows that, until after the commencement of the "reform" movement against the tax in 1897, not more space than a paragraph or at most a page or two was devoted to questions concerning railroad taxation.

> "Earnings," says the commissioner of 1897, "are reported by the railroads themselves to the commissioner of railroads and the latter simply does the clerical work of computing the tax."*48

This fault of being a self-assessed tax, unless a remediable one, is without doubt a fatal defect in any earnings system of taxation since no government can safely entrust to the taxpayer the self-determination of his payments.

III. The Public Attitude Toward the Tax.

The system of railroad taxation upon incomes underwent marked alterations of favor and disfavor among the people of the state during the three decades of its existence. The inception of the tax was marked by a thoroughgoing endorsement from a committee of the National Association of Railroad Commissioners.

> "Finally," says the committee report, "the committee will say that of all the systems of taxation (railroad taxation) examined by them, those in use in England, among the countries of Europe, and in Michigan and Wisconsin among the states of the Union, seem to them most intelligent and in conformity with correct principles. The Michigan and Wisconsin systems would seem to be especially commendable."*49

The approbation here expressed seems to have been but slightly in excess of that felt by the public. The period of the gross income tax was a period during which taxes on incomes generally had experienced little of the ebb in popularity which they have since suffered. The Michigan tax was a levy upon the incomes of corporations and consequently shared in the current general approval which was given to this species of imposts. It was uniformly commended—at least until overtaken by the "reform" movement—by railroad commissioners, governors and other state officials, who had occasion to mention it, as a system with undeniable merits and with few superiors.

The disfavor on the other hand to which the tax succeeded became toward the end fairly overwhelming. The compulsion which was felt by the members of the first State Board of Tax Commissioners as de-

*47R. R. Com. Rep. 1897, p. 41.
*48R. R. Com. Rep. 1897, p. 40.
*49R. R. Com. Rep. 1878. Report of the Com. on Tax., National Association of R. R. Com.

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scribed by themselves may be taken as an accurate expression of the antipathy of the people of the state in the late nineties toward the gross income levy.

> "We are free to admit," says the first report of the commissioners, "that these thoughts or conclusions" (conclusions upon the propriety of revising the railroad taxation laws) "are shaded, if not largely influenced, by the demands of the people as expressed in part and with great force in the results of the recent elections. Indeed, we believe they are so intensely aroused that they will not brook, from any official, interference with the enactment of laws tending to carry their desires into fruition."*[50]

The explanation of this revulsion of feeling toward the tax is largely found in the financial panic of 1893. The wide reaching business distress which broke upon the country during this year reduced at once the earnings of the railroads, and as a consequence—wherever the gross income tax was used—reduced their liability to taxation. The tax receipts from the Michigan roads during the first two years of this depression were lessened by more than a quarter of the amount which had been paid during the last year before the panic began—the actual amount of the falling off equalling in fact some $217,625. This appreciable loss in revenues came, too, at a time, unfortunately, when a large and increasing deficit in the state treasury turned public attention toward the fiscal affairs of the commonwealth and the misfortune of the shrinking railroad taxes was in this way emphasized.

The fact that the roads were paying less taxes upon their valuations than other property paid was another telling condemnation of the impost. The first of Governor Pingree's taxation messages showed that the amount of taxes which was being collected from these properties, if taxed as property, would require a taxing rate of only one-quarter of one per cent, while other property was burdened with a rate in excess of two per cent.*[51] The insufficiency of the amounts drawn from the roads had often been suggested by railroad commissioners and even by those who most favored the gross income method, as a system of taxation, but it remained for the "great appraisal" of the roads, which came near the end of the "reform agitation," to demonstrate the alarming extent of this insufficiency.

The inadequacy of the receipts from the gross income tax became apparent, indeed, even to the staunchest friends of the system long before the proofs to which reference has just been made were completed. But this offense of inadequacy, even when it became apparent, was condoned, however, by friendly critics as being a mere defect in applying the tax —a defect which could be easily remedied by simply increasing the rate. On the other hand the defectiveness which was shown in the gross income tax by its operation during "hard times" was a defectiveness of principle against the evil of which no remedy was easily apparent.

*[50]Rep. of Tax Commissioner of 1900, p. 139.
*[51]Special Message May 6th, 1897, p. 5.

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CHAPTER THREE.

THE PROPERTY TAX ON RAILROADS.

The relinquishment of the tax on income after thirty years of service for one on railroad property was a change of such radical character as to merit at least running explanation. Further than this, the reform —"equal taxation reform," as it is called—deserves description on account of certain by-products of which it was the source whose merits are fairly inestimable.

The first of these was the origination of many of the peculiar features of the subsequent taxing statute such as the method of rate determination and the character of the assessing board. Secondly, the intelligence of the public was educated by the prolonged struggle which ensued for the new method of taxation so as to render efficient aid in administering the new tax after its adoption. Following the brief sketch of the reform movement which is here given, the characteristics of the new tax will be studied and in a second chapter some details of its operation will be noticed.

I. The Reform.

The business depression which followed the "panic" period to which reference has just been made was so universally distressful that the ordinary state and local tax levies were met with difficulty by the people and were causes of wide spread complaint. The discontent of the Michigan taxpayers is fairly reflected in the legislature of 1895 through the action of this body in establishing the office of state tax statistician.*[1] The duties of the occupant of this office were, in general, similar to those usually conferred upon the familiar advisory state tax commission whose periodic reappearances in the different states bear eloquent witness to the stubbornness of the tax problem. It was doubtless due to the attempt of the first statistician to investigate single-handed and at the same time, all the problems which are usually assigned these commissions, that his efforts proved so fruitless as was the case.

The difficulties of the taxpayer in meeting his obligations, owing to the "hard times," were voluminously set forth, also, to the state board of equalization at its meeting in 1896, by the representatives from the various counties. The report of the board of equalization for this year may still be read with profit by those who desire an insight into the paralyzing effects of "crises" upon industry, and, when proper allowance has been made for the customary exaggerations of these county representatives, it still remains true that tax payments would be met with real difficulty. The board at any rate reduced the equalized value of the property in the state by twenty-five millions from what it had been in 1891.*[2] During the same period of years, too, the assessed valuation of property had been diminished by more than six millions.*[3]

*[1]Mich. Statutes 1895, p. 597.
*[2]Rep. State Board of Equalization 1896.
*[3]Mich. Manual 1899, p. 276.

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Both the retiring and the incoming governors at the end of 1896, devoted large portions of their messages to the subject of taxation. Governor Rich, who had been hampered throughout both of the two terms of his administration by large annual treasury deficits, urged the propriety of laying a general corporation tax, a franchise tax, a tax upon building and loan associations, upon banks and mutual benefit and fraternal organizations, upon kerosene oil and upon salaried persons—in all no less than six new taxes.*[4] Governor Pingree was even more insistent upon tax reform, which should relieve the general property taxpayer, than was his predecessor, and, in addition to those already mentioned, his message proposed the ad valorem tax for the public utility corporations and the adoption of an inheritance tax.*[5]

The legislators to whom these messages were addressed, grappled vigorously with the problem of readjusting the public burdens and it soon became evident that sacrifices would be demanded from the railroads, since within the first few weeks of the legislative session more than forty measures affecting these properties were proposed.*[6] A special message from Governor Pingree upon railroad taxation, focused legislative interest upon this subject toward the end of the session,*[7] and gave a definite direction to the search for new sources of revenue. The governor in brief in this message urged that the railroads paid less taxes in proportion to the value of their property than other property paid, that the gross income tax was inelastic and was awkward as a source of revenue during times of business depression, that the Michigan system was not uniform with the systems found in other states, and, finally, that Michigan received less revenue from railroads than other states secured from these properties.

The reform movement, which may properly be considered to have commenced with this message, was to involve consequently a change in the methods of taxation employed in this state as well as to develop more equality in the amounts which were paid. Uniformity in methods of taxation was to be struggled for the message urged since "there is but one rule" (concerning taxation) "consistent with honesty; that rule is to place all property upon the same footing." In the closing days of the session another message was transmitted to the legislature containing a lengthy argument from Railroad Commissioner Wesselius inveighing against the constitutionality of the gross income tax.*[8]

No measure had appeared thus far, however, which brought the railroads within the general property tax and still retained the centralized method of administration. When a bill of this sort was ready during the second year of the Pingree administration, a special session of the legislature was summoned and a discussion rarely given to taxation measures in Michigan ensued. Hearings were granted the railroads during the early days of the session and the attorneys of these properties appeared for the purpose of instructing the legislators upon the views of taxation held by men connected with railroads. Former state governors were summoned. One of these, ex-Governor Rich, condemned the

*[4]Ex-augural Message of Gov. Rich 1896, Sen. Jour., p. 22.
*[5]Inaugural Message of Gov. Pingree 1896, Sen. Jour., p. 53.
*[6]Railroad Com. Rep. 1897, p. VI.
*[7]Special Mess. House Jour. 1897, p. 2006.
*[8]House Jour. 1897, p. 2641.

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proposed law and defended the gross income tax upon railroads;*[9] another, ex-Governor Luce, declared that an "equalization of the tax payments made by railroads with those made by other property was an equalization much needed."*[10] One United States senator communicated a letter opposing any change in the system of taxing railroads; the other senator favored some equalization of these taxes.*[11]

The preliminary hearings on the bill lasted more than two days, and, since the contentions in the legislature were mainly upon the form of taxation—all legislators being in accord upon the justice of increasing the payments from these taxables,—the railroads stood alone in their attitude of opposition to any change. It was emphasized by their representatives that railroads are a peculiar property—"a property," as the usual phrase went "dedicated to the service of the public,"*[12] and consequently special consideration should be shown them in taxation. Railroads in Michigan were described as unprofitable enterprises owing to high operating expenses.*[13] Especial note was made of the provision in the proposed law which taxed franchises and also of the fact that other property was remiss in paying taxes,*[14] and, finally, the existing system of taxing railroads was warmly commended by all of the railroad representatives as possessing all the qualities of an ideal system. The bill received two days of discussion in the House, and this was followed by two more in the Senate. In the former body it received an almost unanimous vote—three ballots alone being cast against it, while in the latter body it was defeated by the narrow margin of two votes.

The question was now squarely before the people of the state, and in the autumn campaign for the election of state officers, "equal taxation" was endorsed in the platforms of both parties—the Republican platform specifically mentioning the recently defeated measure—"Atkinson bill" as it was now called—as being worthy of support. The state grange association and the state farmers' clubs representing the wishes of many hundreds of farmers also adopted strong resolutions of endorsement at their annual autumnal meetings.

There seems, indeed, it may be said parenthetically, to have been no equivocalness at any time in the expressions of popular desire for taxation reform in any instance where public feeling upon this matter was declared—the attractiveness of the reform catch word "equal taxation" and the customary unpopularity of large corporations working incalculably toward this end. The measure had been petitioned for by more than 70,000 signatories,*[15] when before the legislature and the constitutional amendment, which was submitted eventually in the year 1900 in order that the legislature might enact an ad valorem taxing law, was carried by a plurality of half a million—a plurality which was more than twice as large as the total of any previous vote upon a constitutional amendment which had been cast during the previous history of the state.*[16]

The newly elected legislature of 1899 accepted at once the duty of enacting a reformed railroad taxing law but a controversy prolonged

*[9]Jour. of the Senate Appen. 1898, p. 35.
*[10]Sen. Jour. Appen. 1898, p. 44.
*[11]Letters from Senators McMillan and Burrows, Det. Free Press Mar. 19, 1898.
*[12]Meddaugh, House Jour. 1898, Appen. p. 92.
*[13]Hanchett, House Jour. 1898, Appen. p. 49.
*[14]O'Brien, House Jour. 1898, Appen. p. 92.
*[15]Holmes, Sen. Jour. 1898, p. 189.
*[16]Mich. Manual 1901, p. 307.

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through two months followed—so stubborn was the adherence of the gross earnings partisans to the old tax. Before joint committees of the two houses representatives from nearly all of the important railroads for the second time urged their opposition to the proposed measure,*[17] and, as the legislative discussion continued, popular agitation again came to the assistance of the bill. The state association of township supervisors,*[18] the state meeting of the farmers' institutes*[19] and many of the county Republican judicial conventions*[20] which were convened for the purpose of nominating a candidate for a supreme court judgeship contributed resolutions of strong endorsement for the pending measure.

The duration of the new law when finally enacted*[21] and which received the governor's signature late in March, was quite as brief as its enactment had been prolonged. By the end of the following month the supreme court had declared the act invalid because it was not a specific tax since property was levied upon in accordance with value; neither was it a constitutional property tax since it violated the requirements of uniformity through employing a state board of assessors for assessment purposes instead of the local officials of this sort who were usually employed.*[22] The most persistent criticism which had followed the bill during its history was the charge that it was an unconstitutional measure, and latterly, the firmest friends of the proposal having become impressed with this charge, the governor himself brought the suit which established the invalidity of the law.

The opponents of reformed railroad taxation it may be said in retrospect had been rewarded with victories from time to time during this half decade of taxation controversy which had materially delayed the enactment of the new law. The legislative session into which the matter was first introduced, for example, was rendered fruitless so far as the enactment of an ad valorem taxing law is concerned by the adoption of a new gross income tax—the Merriman law—by which the revenues from the roads were substantially increased but without the desired adoption of a new plan of taxation.*[23] The enactment of the still born taxation law, whose fate before the supreme court has just been described, may also be considered a victory for those who favored the gross income tax, since it was thoroughly believed by those who acquiesced in the passage of this measure that it would prove unconstitutional when adopted.

Before the close of the legislative session whose activities, as we have seen, were unfruitful in procuring a constitutional taxing law, the opponents to reform achieved still another victory—the establishment of a tax commission which should study tax conditions and report their findings to some later session of the legislature.*[24] The board thus provided assumed at once the duties which were prescribed by its organic law, and the vigor and intelligence with which it acted secured for it immediately a place of respect in public esteem, and it has since become a permanent feature of the state taxing system.

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*[17] Det. Free Press Feb. 24, 1899.
*[18] House Jour. 1899, p. 252.
*[19] Farmers' Institute Report 1899.
*[20] Det. Free Press Feb. 1899—See issue of almost every day in this month.
*[21] Laws 1899, Act 19.
*[22] Pingree vs. Aud. Gen'l., Mich. Rep. Vol. 120.
*[23] Statutes 1897, p. 293.
*[24] Statutes 1899, Act No. 154.

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The contentions of those who resisted the new plan shifted from time to time, but in the main these antagonists to change in railroad taxation opposed the reform measures as being unconstitutional, as being a menace to the cherished school fund, and, as being undesirable, through necessitating the extension of the faulty general property tax to new taxables. The limitation of the new tax, too, to the general law roads was apparently condemnable also and proved a hindrance to reform since no effective plan had yet been proposed for doing away with the specials charters.*[25]

The constitutional amendment which had been adopted at the autumn election of 1900 removed all hindrances of a legal sort to the enactment of a tax on railroad property, but at the regular session of the legislature in 1901, a discussion, continued throughout two months, was necessary before the adoption of a new law was secured. The measure had been endorsed for the third time in the platforms of each of the two leading political parties, and both the incoming and the retiring governors had urged its adoption upon the legislature..

The struggle at this time was not upon the principle of reform, since even the railroad attorneys in their renewed addresses to the legislative committees*[26] now advocated the property method of railroad taxation, but upon the details of the new law. Should the proposed law include telegraph, telephone, express, sleeping car and chair car companies, should a separate board of assessors be created, or should the tax commission administer the law, and how should the rate be determined were the most troublesome problems of this sort.

The bill was finally drawn to exclude telegraph and telephone and sleeping car companies and to include the others and its administration was to rest with the Board of Tax Commissioners, enlarged to five members.*[27] A distinct compromise decided the method by which the rate —the average rate at which other property paid taxes throughout the state—was to be computed, since two plans had divided the legislature implacably from the first upon this matter. The first plan provided that the rate-making should be nothing more than a mathematical computation—a mere division of the total tax of the state by the valuation of the property of the state, the quotient standing as the rate sought. The advocates of the rival plan insisted that general property was undervalued for taxation purposes and consequently should be "equalized" before serving as a divisor. No reconciliation upon this matter between the opposing sides was possible, seemingly, and, eventually, the scheme was adopted of drafting into the bill the words which had been used in the recently adopted amendment to the constitution, leaving it to the courts to determine the meaning of these words. The bill which had monopolized the interests of three regular sessions of the legislature and was the sole subject of interest for four special ones, received the signature of Governor Bliss, May 2, 1901.*[28]

The taxing law following its adoption underwent prolonged adjudication in the courts. In 1902 suits were brought in the Federal courts

*[25]Sen. Jour. 1898; pp. 116-124; also Appen. pp. 54-59.
*[26]Det. Free Press 1901, April 2.
*[27]Det. Free Press 1901, Apr. 2nd to May 22nd.
*[28]Laws of 1901, Act 173.

NOTE.—The Detroit Free Press of Dec. 22, 1900, tabulates the expenses of the four special sessions at $90,218.33. Of course the expenses of three regular sessions which were devoted to this subject, the railroad appraisal and the long suit in the federal courts, would add materially to the cost of this equal taxation legislation.

by twenty-eight roads for the annulment of the law on the grounds of unconstitutionality, and against the first assessment under the law in particular because of the excessiveness of the amounts of taxes which had been levied. The suits resulted adversely to the companies both in the decisions of the inferior and of the Federal supreme courts, and, after a period of not less than eight years from the time of its inception, the ad valorem taxation of the roads became, on June 21, 1905, the established law of the state.*[29]

The "equal taxation" movement easily surpasses all others as the foremost political battle both for intensity of interest and for length of duration of any which the state has ever experienced. The controversy is entitled to its full share of discredit, too, on account of the political factiousness which it engendered. Zealousness for proper railroad taxation seems indeed not infrequently to have been lost in the clash of political combat. Mainly, no doubt, this resulted from the greatness of the interests involved, but to no small extent the methods and bristling personality of Governor Pingree, the reform leader, augmented unnecessarily the real difficulties which lay in the way of tax reform.

II. The Taxation Law.

The new law established the now widely used method of taxing railroads—the modified general property tax—and was confessedly adopted from an Indiana statute. It was, like its predecessors, the sole tax on railroads, was to be levied only upon the railroad property actually in use by the road, and of course, only upon the railroad property within the state. This property, by the terms of the law, was to be assessed at its "true cash value" by a "state board of assessors" and at a "rate" which should be the average of the rates levied upon all other property throughout the state.*[30] These three provisions were the significant features of the new law and each in turn is deserving of comment.

1. Assessment Provisions.

So prolonged had been the struggle over the law and so inclusive of all fiscal interests that some of the accessories to the new taxing method had crept into existence ever before the tax itself had been adopted. Foremost among these was a valuation of the railroads—the foundation itself for the new tax. Railroad taxes having always drawn from some other source than property in Michigan, there existed for taxing purposes no valuation of these properties of any sort. Few topics consequently had received more discussion in the late controversy than had those concerning the probable worth of these utilities, and, derivatively, the relative burdensomeness of railroad taxation as compared with the burdens borne by other property of similar value. It was for the solution of this last problem that the state was moved at last to employ a staff of experts to compute or appraise in the most thorough manner possible the value of the railroad property within its limits.

This now most famous of railroad valuations is known as the "Michigan railroad appraisal" and its methods have been adopted by other

*[29]See 138 Fed. Rep. p. 223 for decision of District Judge Wanty; 207, U. S. Rep. for decision of Justice Brewer.

*[30]Laws 1901, Act 173.

states and approved by the congressional industrial commission of 1900,*[31] by the interstate commerce commission*[32] and by numerous text-book writers.*[33]

The chosen plan of valuation, which received the distinction just indicated, involved a complete inventory of the material or physical elements in a railroad, that its reproduction worth physically might be determined. This was supplemented by the value of its franchises and good will, "or the whole of that immaterial non-physical worth which is sometimes known as corporate excess."*[34] This last was a capitalization of a residuum of average earnings after the portion earned by the physical investment, taxes, operation expenses, etc., had been deducted, and it is doubtless the use of such an inventory and the employment of earnings in determining corporate excess which constitute the chief merits of the plan.

Any attempt at an adequate review of this appraisal would exceed the scope of this discussion but it may not be wholly amiss to notice two services at least which it has rendered to the people of the state beyond those contemplated by its authors.

First, It was relied upon by the state, corrected to date, as defense from the charge of over-assessing railroads in the Michigan tax cases before the Federal courts in 1902.*[35]

Second, In a remarkably low valuation of railroads by the board of assessors in 1906, the attorney general of the state had the appraisal developed to date as a means of publicly convincing the assessing board of its error in valuation.*[36] Michigan apparently, therefore, is fortunate in having a standard which may be resorted to as a touchstone when railroad valuations are in doubt.

Nothwithstanding the possession of this costly appraisal or the reputableness of its methods, no influence from it is discernible in the assessment provisions of the new law. The framers of the law refrained, indeed, from designating any method of valuation as the chosen method for assessment purposes and catholicly made room for the use of any or all plans which might be devised. Processes, in fact, as yet undeveloped are not denied the use of the assessing board by the provisions of the law since "such other evidence as may be obtainable bearing thereon" (on railroad values) is within its competency to employ. The liberality here shown has the approval of custom in other states and the endorsement of assessing boards generally though a latitude of such large proportions is markedly in contrast in Michigan with the statutory restrictions upon the ascertainment of "cash value" by the assessors of ordinary property.

The struggle for a more vigorous taxation of railroads could make but little headway anywhere without discovering so vulnerable an asset as the corporate franchise and the wide remove of Michigan from the fiscal needs and methods of older states is suggested by the fact that no earlier appearance of the term "franchise" in a taxing statute in this state is anywhere to be found. Indeed, this much used source of revenue in

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*[31]Rep. Indus. Com. 1902, Vol. XIX, p. 55.
*[32]Rep. Inter. State Com. Com. 1903, p. 29.
*[33]Am. R. R. Transportation, Johnson, p. 43.
*[34]Bulletin 21 U. S. Dept. of Com. and Labor (1904), p. 76.
*[35]Records and Briefs, Mich. Tax Cases, Vol. 49.
*[36]Detroit Free Press 1905, Jan. 22.

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older states had had but one official mention as a taxable in this commonwealth prior to its appearance in the tax reform statute.*[37]

Belated as it was, the proposal to tax railroad franchises met with strong opposition in the legislature and the provision concerning this project was easily excluded by amendment from the first draft of the new law. Besides its novelty, the ambiguity of the term "franchise" was the chief defect to which the legislators objected, including as it does such separate notions as corporate "being and doing," "good will," and "corporate excess," and, though indeed included finally within the taxing statute, "said franchises (were) not to be directly assessed but (were) to be taken into consideration in determining the value of other property."*[38]

Faultless in truth as is the taxation of railroad franchises as a matter of principle, as much may not be said for their assessment unseparated from other railroad property, and for at least two reasons. *First*, unseparated taxation of franchises prevents a desirable clearness to the taxpayer as to the exact property elements upon which he pays taxes and there is no administrative difficulty which compels such concealment since the direct franchise tax is already widely used in several states. *Second*, with the growing use of this tax in other states proclaiming it a desirable source of revenue the opportunity was seemingly lost here of establishing the tax on a sound basis for further growth in Michigan. It is indeed not clear what purpose was served by the statute in mentioning a taxable as subject to assessment only immediately again to fuse it into another taxable of which it was already a recognized part.

The strictly administrative needs of the new law in its assessment provisions are apparently well satisfied through the empowerment of the assessing board with the customary prerogatives of subpoena, requirement of reports, and access to public records and documents. The assessment was to be spread upon a tax roll with the usual privileges of review accorded to the railroads. "Wilfull assessments" the law provides, finally, in serio-comic style, "at more or less than what the members taking part in making the assessment believe to be true cash value" is a misdemeanor severely punishable upon conviction.

2. *The Tax Rate.*

The listing of railroad property upon the assessment roll—the first goal of the reformers—was now provided for along eminently regular and conservative lines—the tax to be imposed is next considered.*[39] "Equal taxation" meant nothing to the partisans of the new law if not the imposition of the same tax rate upon railroads that other property bore—"a tax rate which should be the average rate," as the formalized expression ran, "of all the taxes levied throughout the state." The "average rate" idea sprang naturally from the circumstances of the reform agitation but no similar spontaneity attended its issue into practical form as the long controversy upon rate constituents which ensued abundantly shows.

The name itself had long been used in the tax laws of Michigan to designate the rate levied upon telegraph and telephone properties, and

*[37]Ex-augural Mess. Gov. Rich 1896.
*[38]Laws of 1901, Act 173.
*[39]Laws 1901, Act 173.

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consequently was not unfamiliar to the readers of the state reports. The connotations though of the term in its earlier and in its later use are so different that little more than the name alone may be regarded as derived.*[40]

For the new average rate "the said state board of assessors," so the statute of 1901 commands, "shall ascertain and determine the average rate of taxation for the then current year levied upon other property upon which ad valorem taxes are assessed for state, county, township, school and municipal purposes." And to the furthering of this end the requirements continued "the county clerk in each county * * * the assessing officers of cities and villages, shall report the amount of taxes to be raised in such municipalities * * * and the aggregate valuation of property as taken from the assessment rolls."

An unusual and complex tax rate, such as one must be, which is computed after this fashion, is easily assailable, and the one in question was speedily attacked, both as to its equitableness and as to its legality. Concerning this latter vulnerableness, though of vast importance to the act itself "since the first and principal matter of attack" declared the Federal supreme court in adjudicating the measure "is the average rate,"*[41] yet further than to note that questions of credit, exemptions, rehearings, equalizations and taxing authority formed the basis of the legal attack, extended comment in this direction seems unimportant to this discussion since the alleged imperfections were largely of a strictly legal and technical character.

The equitableness of the "average rate," however, was condemned, mainly, because in computing it different taxing jurisdiction were seemingly confused together thus depriving the railroads of the customary situs benefits enjoyed by other forms of property. Railroads amenable to such a rate were apparently additionally burdened by every increased tax levy in any of the taxing areas of the state, though, through having their residence elsewhere, they might share in none of the benefits which resulted from these increased levies. A controversy which had many of the characteristics of the famous one between nominalists and realists in their medieval philosophy followed —friends of the law claiming that the data from the assessment districts furnished only a convenient reference material for the computation of a rate; the opponents to the measure asserting that this data was final and determinative.*[42]

The grievances arising from conflicting tax jurisdictions, claimed here, seem indeed, upon inspection, to have been more imaginary than real, since certainly no taxing area would permit the overtaxation of itself for the purpose of adding to the burdens of railroads, while on the other hand a normal increase in any taxing district would affect scarcely perceptibly any "average rate." The peculiar nature of railroad property, too, seems to make it a property whose interests far exceed the boundaries of the local taxing area, and therefore justifies a broadened amenableness to taxation.

On the other hand the uncertain meaning of "aggregate valuation of

*[40]Laws 1881, Act 168.
*[41]Mich. Tax Cases, 207 U. S. Rep., p. 293.
*[42]This matter is discussed very fully in House Jour. 1899, Vol. III, appendix. In 133 Mich Rep., p. 121 and in the Opinion of Att'y Gen. Oren upon "rate determination" Tax Commissioner's Rep. 1903-4, p. 37.

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property"—the property valuation which should be divided into the sum total of taxes to produce the "average rate"—gave an opportunity for injustice to the railroads through the "average rate" which could not be doubted. Did the phrase "aggregate valuation of property" mean "property" at its assessed value, its real value, or since Michigan has a board of equalization, its equalized value? The answer which might be made to this inquiry was indeed of no slight concern to the railroads as the subjoined table of opportunities and results, which the first assessment—that of 1902—developed, concerning this matter of valuations plainly shows:

	Millions.	Average Rate.	Resulting Tax Levy.
Real Valuation of General Property (as determined by Board of Assessors)..........	1715	.014	$2,780,000
Assessed Valuation........................	1418	.017	3,556,000
Equalized Valuation........................	1578	.015	2,978,000

The wide famed disparity between the assessed valuation of property and its real value—a fame as wide extended as is the use of the property tax itself—proved no small hindrance in fact to the adoption of any ad valorem railroad taxation measure, whatsoever, largely through the vital dependence of the "average rate" upon some one or another of these valuations. The weightiness of the difficulty is only feebly reflected by the vacillations in choice of valuations which are presented by the different ad valorem tax laws which were perfected or enacted, although the existence of legislative uncertainty upon the matter is at least clearly shown by the display. Briefly summarized the first bill introduced—the "Atkinson bill"—made use of the "equalized" valuation in developing the rate;*[43] the law which was declared unconstitutional used the "equalized" valuation plus a correction through the addition of railroad property;*[44] the final measure, as passed upon by the courts used "assessed valuations"*[45] while the first amendment to the taxing statute which was adopted provided that a "real" valuation should be employed.*[46]

The clew to such radically different alterations as these is found in the desire of the lawmakers to balance the taxation of fully valued railroad property with that of undervalued general property through changes in the rate. All equalization schemes of this sort, however, were ultimately ruled against by the courts, and, although the balancing of the tax burdens upon the two kinds of property by changes in this factor still has many advocates, further comment upon the rate and its problems seems unprofitable until its practical operations and those of equalization have been studied.

Whatever may be the merits of the "average rate" in comparison with other rates (as the arbitrary rate for example)—and it is one which has come into use in several states since its adoption by Michigan—

*[43]Sen. Jour. 1898, p. 23.
*[44]Laws 1899, Act 19.
*[45]Laws 1901, Act 173.
*[46]Laws 1905, Act 282.

NOTE.—In the final enactment of the taxing law—the constitutional one—the legislature frankly confessed its inability to decide between the competing "valuations." Ultimately it drafted into the statute terms identical with those in the constitutional amendment and committed the choice to the courts

its employment in this state is strictly circumscribed since by the constitutional amendment, which authorized the ad valorem system of taxation, only property assessed by a state board of assessors is taxable with this rate.*[47]

3. *The Board of Assessors.*

The state board of assessors, composed *ex officio* of the state tax commissioners, to whom the administration of the new law was intrusted numbered at first five members, appointed each for a term of six years, but with differing dates of retirement so that inexperienced men might never wholly make up its membership. The board was without precedent in Michigan, and in the legislative debates upon the original ad valorem taxing measure, it was strongly urged that its membership should be composed of certain state officials. This, together with the amendment that the board should be elective, added by the senate to the original Atkinson bill, was rejected in the final law which provided for a special board to be appointed by the governor.

So infrequent were the occasions for assessing railroads that, through motives of economy, this duty was assigned the state board of tax commissioners though the earlier unconstitutional law had provided for a highly paid board whose sole function should be the administration of this law. With the annulment of the chief duties of this board as tax commissioners in 1905, the membership was reduced to three whose chief concern is the administration of the railroad tax.*[48] The curtailment here imposed by circumstances was not at all out of harmony with good policy, since under normal conditions, the board is open to public opinion for direction and control and the much greater amenability of the small board as compared with the large one to such control is well known. Among the minor duties of the board none are so important as that of maintaining a permanent office at the seat of government.

*[47]Mich. Manual 1901, p. 47.
NOTE.—The Governor is now a member of this board. See Laws of 1909, p. 78.
*[48]Laws 1905, Act 281.

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CHAPTER FOUR.

THE OPERATION OF THE PROPERTY TAX.

The administration of the tax centers about the two processes of assessment and of rate determination and, following a brief description of each of these, some notice will be given to results.

I. The Assessment Process.

The assessment of railroads though serving the same end as the assessment of other property benefits but little from the methods used in valuing ordinary property for taxing purposes. None of the familiar indices, for example, which the local assessor employs in order to value taxables such as probated or selling values of property, the price which a property owner will take or some possible purchaser will offer, are available for assessing railroads, since these properties are never probated, are seldom sold as entireties, nor offered nor bid for upon the market. For similar reasons even the tests of "cash value" which are the legal guides to ordinary assessments, such as "what a property will sell for at other than a forced sale" or what a property would be valued at in settlement of a just debt due from a solvent debtor" are not practicable tests in the assessment of railroads.

In addition to the absence of a market price a railroad involves so much wealth in its roadway and equipments that any assessment to secure credence must usually rest upon well known data, such as value of securities, costs, earnings, etc. The assessments of railroads, therefore, are computed or synthesized assessments and are always spoken of as following some "method" or "plan."

Not a little of the "plan" or "method" which the Michigan board of assessors used in putting together its assessments may be inferentially gathered from its biennial reports.*[1] A more intimate view of its processes, however, may be had from the testimony of board members themselves when upon the witness stand in the "Michigan tax cases" where the character of the first assessment for levying the railroad tax was involved.

The board neglected nothing, seemingly, as gathered from these reports, in preparing itself for this fundamental assessment process.

> "Detailed facts with regard to the assessment and valuation of railroad property throughout the various states of the Union has been gathered," so the reports assert, "no less than thirty different states having furnished this board with the results of their work in this direction." "Correspondence with the United States census department, as well as the interstate commerce commission, and material assistance rendered by the office of the secretary of state and railroad commissioner of Michigan have served to increase the

*[1]Reports of State Board of Tax Commissioners—Assessors 1900, pp. 63-70, 128, 139, and 143-182; 1902, p. 50-70; 1903-4, p. 30-53; 1905-6, p. 18-44.

knowledge of the subject to no small extent." "The entire set of results"—results of the Michigan railroad appraisal consisting of thirty-three typewritten volumes of data and correspondence "now exists in the office of the tax commissioner and has formed one of the most important parts of the basis of valuation used by the board." "Much valuable correspondence with the railroad companies, as well as the results of individual research was transmitted by Prof. Adams to this office." "The results obtained by ex-Commissioner Robert Oakman in his capitalization of railroad net earnings form another part of the investigation carried on during the progress of the Michigan railroad appraisal as does the study of the stocks and bonds of the companies as pursued by ex-Commissioner Campbell." Finally, reports were secured from the railroads which embodied "practically the whole blank form prescribed by the Federal interstate commerce commission."*[2]

And from the "railroad tax cases" we have the testimony of the official engineer of the board, who "attended every meeting of the board save the final two" and "whose duties included advising the board in an expert capacity of the values of properties under consideration," that the board "gave consideration to the stock and bond plan, capitalization of earnings and to appraisal supplemented by capitalization of surplus." "They considered many different plans, the history of the different properties, and other considerations which had a bearing on valuation."*[3]

The testimony of this engineer supplements that of the board members in these cases, where the state undertook to show that the railroads had been under-valued by the board of assessors, and conjointly, the testimony of the two is as follows: The members of the board in the first assessment were able to classify themselves into the "high men" and the "low men"—a difference of more than twenty millions standing between the minimum at which the former would assess the roads and the maximum of the latter. By argument and discussion this difference gradually disappeared, so it was testified, and by some accommodation of views an assessment which was tolerable to all was arrived at.*[4]

The meetings of the board developed strong feeling among its members, since twice at least, according to the court records, threatening language was used by commissioners against their associates.*[5] They also developed discussions not strictly pertinent to railroad assessments such as the probable amount the railroads would stand without contesting the tax in the courts. All the commissioners who testified remembered comments on this matter among members of the board.*[6]

The board also gave consideration to the propriety of assessing railroads at the percentage of cash value at which it was thought other property in the state was assessed, but this species of equalization between railroad and other property was speedily abandoned. In short, the testimony develops the conclusion that personality counted for much in the board meetings and that mere argument was a main factor in determining the assessments.

A review of the assessment roll thus prepared was still to be made

*[2]Tax Comm. Rep. 1902, p. 52-57.
*[3]Abstracts and Records "Mich. Tax Cases," Vol. III, p. 1203.
*[4]Abstracts and Records "Mich. Tax Cases," Vol. III, p. 1295.
*[5]Abstracts and Records, Vol. III, p. 1198.
*[6]Abstracts and Records, Vol. III, p. 1196.

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and the railroads almost without exception appeared before the board in opposition to the amounts assessed against them. The transcripts of the protests listened to by the board from the railroad representatives shows the use of almost every argument conceivable to the railroad mind. One is an attempt to alarm the board through the statement that the president of the largest railroad system in the state spoke of resigning when the amount of the assessor's appraisal was brought to him.*[7] Again the veriest detail of the board's appraisal is found fault with. The efforts of the roads were rewarded, however, since more than eight millions was subtracted from the original assessment.

The earlier railroad appraisal—Michigan appraisal of 1901—was in the hands of the board and celebrated as it was abroad and enjoying public confidence as it did at home this appraisal might not unreasonably be thought to have influenced the assessment. Incidental suggestion of this is indeed found in the close similarity in amounts between the board's assessment and the appraisal, but the search is a fruitless one in the utterances of the board for any acknowledgment that the appraisal was of exceptional usefulness.

The resort to an arbitrary assessment like the one described, where final judgment results merely from merging individual ones, was a wide remove from the original conception of the assessing process which the board had held.

> "A systematic, complete and fair valuation of the railroad properties of Michigan at this time" their first report narrates—and the hope expressed here seems fairly representative of a current popular one—"if put into shape for reference would obviate the necessity for another complete valuation for many years." "If railroads are to be assessed upon valuations, only men capable of doing this work by training and experience, can find even approximate valuations, and this should be done so openly that not the faintest suspicion may attach to the assessing board nor to the corporations themselves. Any private office valuation would lead to grave charges."*[8]

The unexceptionable program here sketched was wholly discarded, as we have seen, by the board when confronted two years later with an actual assessment.

> "Though the general trend of thought," says their report at this later time, "among all who have written upon this subject"—the assessment of railroads—"is in the direction of some one plan or method sweepingly applied to the entire list of railroads, within a state. * * * It is the opinion of this board that no one plan may be arbitrarily applied but that each individual property should be subjected to an examination covering every possible phase of the question.*[9]

The choice on the part of the board to use a "private office," secretive or arbitrary judgment method of valuation instead of the one which has just been outlined may be explained as the choice which would meet with the least resistance. None of the several methods of appraising railroads, which have found a place in the practices of tax commissioners though logically satisfactory and of wide practical use, have anywhere had full legislative or judicial approval so that the sweeping ap-

*[7]Pond, Hearings before the Board of Assessors 1903, p. 154.
*[8]Report of Tax Com. 1900, p. 64.
*[9]Rep. of Tax Com. 1902, p. 57.

plication of any one of them by the Michigan board would have been wholly experimental. A way mark in railroad taxation was indeed of possible attainment to this board through using and thereby bringing to legal test some one of these methods. Progress of this sort would truly have been valuable to the theory of taxation, but it would have been gained in the instance of the case under discussion at the risk of vitiating the assessment and of prejudicing public opinion against a taxing law not yet firmly established.

The administrative processes of the single-plan-publicly-computed method of assessment, too, must have proven incomparably more difficult than were those of the secretive method. Not only would the plan chosen need establishment in the confidence of the public but in its application it could be attacked by the roads in detail and the particularized defense of each item in a railroad assessment is not a task lightly assumed. Legal and administrative tasks like the ones here suggested were not imposed upon the board by the taxing law and little doubt remains that the use of the secretive,—arbitrary-judgment—species of assessment deserves thorough commendation.

The personnel of the board which should have such large responsibilities in charge as the valuing of railroads was given extensive consideration when the change to the ad valorem system of taxation was first proposed, and it is a subject which is still full of interest through the apparent importance of personality in making assessments. "They should be among the highest heights of men in our state. They are to deal with very, very important interests," was the dictum of the author of the first ad valorem measure in speaking of the membership of the board.*[10] One board at least—the first one—received high commendation from a competent authority. "The original board," says the report of the Ontario tax commission, "was undoubtedly actuated by an enthusiastic zeal and singleness of purpose in its work—and has accomplished great reforms."*[11] No less of praise is due to each of the succeeding boards so far at any rate as the first part of the commendation is concerned and no less has seemingly been accorded them by public opinion throughout the state.

Most of the members, however, have not been allowed the experience in office which the tax commissioner's duties deserve. Ten men have received appointments as commissioners during seven years in only four of which did the membership of the board exceed three; and, although the usual legal term of office has been six years, only one man has actually served this long. Indeed, the average length of service has been approximately three years. Such frequent changes in the composition of the board can scarcely be considered otherwise than as a great deterrent to its efficiency.

The assessment process has been repeated in Michigan six times in all, and with as much experience as this, any study of this prerequisite to the property tax would be incomplete without some consideration of results. The assessments of railroads in their general upward trend correspond closely with the upward trend in the assessments of general property during the same periods as the following table shows:

*[10]Col. Atkinson, House Jour. 1898, App. p. 13.
*[11]Rep. Ontario Tax Comm., p. 46.

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Assessments of railroad property	—1902	$198,641,000
	1903	222,106,000
	1904	196,795,000
	1905	202,651,000
	1906	207,518,000
Assessments of general property	—1902	1,418,251,858
	1903	1,537,355,738
	1904	1,529,969,350
	1905	1,574,422,770
	1906	1,598,935,606

The more acute fluctuations of the railroad assessments,—notably the one of 1903—is a reasonable issue we may believe from the more mercurial movements of a single industry as compared with the steadiness in values of the whole property of a state. The satisfactory fact is that a period of general prosperity is reflected in the upward trend of railroad assessments as it is in those of general property.

Naturally the comparisons which have just been made may be considered indicative in the broadest sense only, of the justness of the board's valuations. The trend of railroad assessments relative to actual railroad values is of much greater practical importance and some suggestions as to the character of this trend may now be given.

Fortunately for this comparison there have been made three authoritative valuations of railroads, other than those which have been made by the assessors, within the period of these assessments. These, arranged in order, show wide discrepancies between the assessments and valuations to the disadvantage of the assessments in each case.

"The Michigan appraisal," 1901, valued the roads at $202,212,199; the assessment of 1902 at $198,641,000.

*[12]A special Michigan railroad valuation by the United States census department, 1904, $277,597,000; the assessment of 1904 at $196,795,000.

*[13]The Michigan appraisal authorized to be brought to date by its authors in 1905 produced the value of $284,710,659; the assessment of 1905 was $202,651,000.

The argument from antecedent probability is not lacking either to the contention that the roads have not been assessed at their full value. The board has constantly urged its conviction that the roads were paying more than their share of taxes. This was its claim in opposing the suit of the Detroit school board in 1903,*[14] in the testimony of its members on the side of the railroads in the "tax cases" of 1904,*[15] and in its application of the Galbraith law to the lowering of railroad taxes in 1905.*[16] Denied the privilege of adjusting the railroad tax in accordance with its conceptions of justice—since the courts declared that this tax must result from a purely "ministerial" computation—the board has seemingly felt itself without other recourse in securing "equality of taxation" than to ignore in part the natural growth in railroad values.

*[12]Bulletin 21, Census Bureau 1904, p. 8.
*[13]Detroit Free Press Jan. 22, 1906.
*[14]Board of Education v. State Board of Assessors, 121 Mich. Rep., p. 133.
*[15]Abstracts and Records Mich. Tax Cases, Vol. III, p. 1203.
*[16]Laws 1905, Act 282.

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II. Problems of the Rate and of Equalization.

A taxing scheme drafted largely from another state, as this one was, has proven far more unmanageable in a new administrative setting than its most ardent advocates could have possibly imagined. Its greatest lack has been for some equalization device by which the taxes drawn from railroads could be brought to a balance with those drawn from other forms of property. The omission of such a device from the original, propagating, Indiana law is readily enough explained through the fact that railroad assessments in that state were made by the state board of equalization. This board as a consequence from its equalization function was therefore the ultimate authority in the assessment of general property, consequently an equation in the values of these two kinds of property for taxing purposes was easily accomplished.

In Michigan, on the other hand, railroad assessments and the equalization process were from the first performed by separate boards and cash value alone—a value wholly ideal in actual practice—at which all the property by statute is required to be assessed, was looked to solely, by the early champions of tax reform, for their basis of equality.

An important outcome from the "great appraisal," however, was the development of a valuation of the roads which the public widely accepted as the real value of these properties. This became, indeed, as we have seen, a sort of standard valuation with which the public tested the merits of matters which involved the quest of railroad values. From a popularly accepted valuation of this sort, few assessing boards would care to hazard popular condemnation by making deductions and, indeed, it is more than probable that legal restraints would have been appealed to for the prevention of such action if it had been attempted by the board. Equalization between railroad and other property in the ordinary sense of adjusting the value of the one to the value of the other, therefore, became impracticable—at least so far as altering railroad valuations downward is concerned.

A species of equalization it was speedily seen, was still possible to the Michigan board of assessors, even without the formal authority of an equalization board and in spite of a somewhat rigidly predetermined valuation of the roads. This was through the power it had of computing "the average rate." This rate it will be remembered should be the "average rate" levied upon other property for state, county, township, and municipal purposes and, in determining the data by which this rate was ascertained, an opportunity for equalization existed, which, without altering railroad valuations to a parity with general property valuations, furnished means for substantially equal taxation. A reduced rate it is manifest would produce the same results so far as tax payments are concerned as would a lowered valuation of railroad property. But a vision of desirable opportunity, however, such as this is was not the one which came to those who first saw this possibility of equalization through the rate. It was that rather, of a hateful danger that the roads would pay more than their share of taxes through the use by the board of assessors of characteristically undervalued general property as the divisor with which the average rate should be determined.

From the many controversies concerning undervalued general property which took place there eventually issued by provision of the legis-

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lature a commission—the Michigan tax commission—which had almost absolute authority over taxation.*[17] To the current assessments of general property for example more than sixty per cent of the increase was added within a short time by this Board, and when, subsequently, to this commission, already empowered to raise or lower assessments, to remove assessing officers, etc., there was also given the determination of the average rate," the machinery for effective equalization between railroad property and other property was seemingly established.

This tax commission in other words with mandatory power over assessments for state, county, township and municipal purposes was identical in membership with the board of assessors, one of whose chief duties, as we have seen, was the determination of the average rate. Clothed with such ample authority as that which has just been described, the board of assessors, acting as tax commissioners, needed only to assess the general property of the state at its true value in order to have data for the computation of an average rate which would effectually equalize the taxation of the roads with other property.

But the merely incidental right of equalization such as this was, fell far short of satisfying the tax commission-assessing board. This Board conceived that the new tax law authorized the use of the real—real in the ideal sense—value of general property as the divisor by which the average rate should be determined, and itself with the power to weight, or manipulate, or adjudge the assessed value of property until it equaled this real value.*[18] The ascertainment of the statutory intention upon this matter has been the most troublesome problem which has arisen in administering the tax as the determination of the equity involved has been the greatest speculative problem. The history of the settlement of the administrative part of this question deserves, therefore, some narration and may be briefly told.

The Board employed, in brief, when the first average rate was determined, an ideal valuation of general property—the assessed valuation plus a make-weight of several millions—as its divisor which resulted in so low a rate that the tax contributions of the railroads to the state school funds were materially lowered. To resist a loss of this kind the Detroit school board appealed to the courts, and, in the decision which resulted, the function of the assessors was defined as a "purely ministerial function"—they were merely to perform the mathematical computation of dividing the assessed value of general property into the aggregate of taxes in order to produce the average rate.*[19] Nothing farther was now left of the board's claim to discretionary or judicial authority over the rate, but, equality between the taxes paid by railroads and those paid by general property, though affecting the rate, was still achievable to the board by virtue of its incidental power to control the assessments of general property.

"To tax and to please is not given to men" runs the apothegm of the great Burke, and, with the expiration of its first half decade, the activities of the "assessors-commissioners" board had rendered it so unpopular that in the legislative session of 1905 the authority of this board over general assessments was almost wholly discontinued.*[20] The board

*[17]Laws of 1899, Act 154.
*[18]Rep. of the State Board of Tax Commissioners 1900, p. 119.
*[19]Det. Board of Ed. vs. State Board of Assessors, 121 Mich. Rep., p. 133.
*[20]Laws 1905, Act 281.

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henceforth, in fact, had no initiative in raising assessments—few of its powers indeed of any sort remaining save those of an advisory character.

The complete suspension after this fashion of the equalization process between railroads and general property, either through, formally equalizing the assessments of these two species of property the one with the other or through affecting the rate, which now prevailed, proved distasteful even to the legislators. A supplementary measure, therefore—the Galbraith law—sought to correct the restrictions which had been placed upon the assessing board and secured ready approval from the legislators. By the provisions of this measure full power was allowed the state assessors "to ascertain and determine" in computing the average rate the true cash value of all property of the state, other than that included upon the assessment roll.*[21] The power which the taxing board had once *assumed* to be a power which was within its possession would be one in reality it was thought if formally so conferred by legislative enactment.

But this was not the view which was taken by the supreme court and the adverse decision from this tribunal quickly invalidated the "Galbraith" law as its earlier decision had overturned the board's unwise assumption.*[22] No practical authority remained now to the assessors of any sort by which the equalization of taxes upon the two kinds of property could be accomplished, nor have any of the remedial devices which have since been proposed secured a place in our taxing machinery.

The equalization performance, whenever used, is necessitated by that imperfection in the general property tax which allows property in two equally amenable districts or two equally amenable classes of property to shirk the fulfillment of its liability. It is, of course, with regard to this latter species of difficulty that our discussion is concerned, and the question arises whether there are in Michigan such inequalities in the taxes drawn from the two kinds of property—railroad and general—as to necessitate an equalization device. Is general property in Michigan perniciously undervalued?

The undervaluation of property of this sort in Michigan is frequently presumed from such circumstantial evidence as affirmative statements to this effect from such administrative officers of the state as governors and auditors, from confirmatory reports by state boards of tax commissioners, from the common popular impression that such undervaluation exists, and finally from the existence of boards of equalization. In opposition to such possible proofs as these there is the very weighty fact that in the celebrated Michigan tax cases of 1902-6 the railroads were unsuccessful in showing that general property is undervalued in Michigan though half their case rested upon this contention. Futhermore, there has never been in Michigan, as in so many other states, any statutory compromising with the full cash value standard by arranging percentages at which property might be assessed. On the other hand the assessed valuations of property in this state have progressively increased from year to year, thus showing a harmony between the work of the assessing officers and the natural growth in property values.

The conclusion seems unavoidable that the absence of an equalization device in the Michigan method of railroad taxation, while not actually

*[21]Laws 1905, Act 282.
*[22]143 Mich. Rep., p. 73. Att'y Gen'l vs. State Board of Tax Assessors.

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entailing inequality of taxation—at least more inequality than is unavoidable in a general property tax—leaves wide open doors for such an outcome. It is doubtless the possibility of such inequality which arouses the strong popular sentiment, which prevails throughout the state, favorable toward action that will deposit somewhere the authority to equalize taxes on railroad and general property.

The remedy itself which shall obtain is far less easily determined than is the necessity for remedy. The truth is obvious enough that the "equalization" which the board of assessors desired to use is not the familiar curative process usually known by this name. The method sought by the board extends beyond the mere rectifying of taxation bases—the end of customary equalization—and seeks either by adjusting the bases, or preferably, by correcting the rate to make equal, relatively, the burdens borne by the two kinds of property.

The reform of the day in taxation matters "segregation of sources,"—though ostensibly a remedy for equalization difficulties—does not touch this sort of equalization. The exactly antithetical reform to the "segregation" reform, the mandatory commission or "Indiana plan," seems indeed much more feasible. The desired balance between the taxes drawn from the two kinds of property must be secured—so the nature of the difficulty seems to imply—by strengthening some board with power to alter assessments, or rates or both.*[24]

The determination of the rate itself, aside from the question of principle involved, seems to have aroused few difficulties. The performances of the board in this direction have furnished the following rates for the corresponding years:

*[23]1902, $16.91; 1904, $16.92; 1905, $17.40; 1906, $16.47; 1907, $17.62; 1908, $18.00 per thousand.

III. Results from the Tax.

The revenue results from the new tax have equalled the highest expectations of the reformers, since the tax receipts from the roads have been more than doubled.*[25] The first payments, indeed, exceeded so strikingly the accustomed returns from the railroad imposts that a threatening agitation was started toward limiting by a constitutional amendment the amounts which should thenceforth go to support the schools.*[26]

The two-fold gross increase in receipts which the new tax developed, when compared with the old, does not measure accurately, however, the entire productiveness of the old tax, since both the mileage and the traffic of the roads were greater during the period of the later tax than during that of the earlier. The vitiation of the comparison, which results from the differences in mileage which prevailed during the two periods may be overcome, however, by showing the increase in tax receipts per mile during the period of the new tax as compared with that

*[23]Auditor General's Rep. 1907, p. 141.

*[24]The State legislature, in the session of 1911, enacted the Lord bill by which the Board of Assessors was reempowered with the authority to reassess property throughout the State upon its own initiative. The opportunity is therefore again given the Board to equalize through assessing property everywhere at its true value.

*[25]Average receipts from road under the gross income tax during the period from 1897-1901, $1,210,129.09. Average receipts from roads under the property tax during the period from 1902-1907, $3,463,809.61. Percentage of the old tax which was equalled by the new, 201.

*[26]Governor Warner's Message. House Jour. 1897, p. 35.

of the old. The trend is as follows and shows a doubling in the receipts of the poorest year under the new tax as compared with the best year under the old:

Average Taxes Per Mile.

Property tax—	First year	$398 09
	Second year	443 18
	Third year	391 07
	Fourth year	410 09
Gross income tax—	Last year	177 43
	Next to last year	167 85
	Next	135 45
	Next	95 13

The most satisfactory test of the superior productiveness of the new tax over the old, however, results from the joint appearance of both exactions during several years. This curious occurrence was the outcome of the determination on the part of the roads to continue paying taxes under the old law until the legality of the new one had been established. The board of assessors levied during the same years the amounts for which the roads were amenable under the new law. The results from the comparisons which follow are not entirely satisfactory since some of the smaller roads accepted the new law from the beginning.

	1902	1903	1904
Taxes paid by the roads as determined by the old law	$1,668,435 86	$1,865,974 86	$1,779,642 86
Taxes determined by the board under the new law	3,288,162 06	3,756,149 42	3,330,350 59
Percentages of the gross income taxes equalled by the property taxes	197.	201.	190.

The effects of the new tax upon the individual roads may be shown by a comparison of the average payments made by the roads each year during the last half decade under the old law with the first period of the same length under the new. The presentation which follows shows the results of the tax upon each road under fairly similar conditions, too, since no data is tabulated for any road which had not paid taxes for five years under the old law and was not presumably therefore a finished road.

The traffic conditions were fairly similar, also, for both the periods under comparison since both were fully included within the group of years dominated by our recent prosperity. The comparison is as follows:

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Road.	Average receipts during five years previous to 1902 under the gross income tax.	Average receipts during five years subsequent to 1901 under general property tax.	Per cent of increase.
Ann Arbor Railroad Co	$40,104 54	$129,320 43	222
Arcadia & Betsey River	270 26	1,263 90	367
AuSable & Northwestern	1,135 22	3,018 47	166
Chicago, Kalamazoo & Saginaw	1,771 56	8,320 27	370
Chicago, Milwaukee & St. Paul	8,045 52	59,981 63	744
Chicago & Northwestern	72,983 29	219,245 55	200
Cleveland, Cincinnati, Chicago & St. Louis (C. W. & M.)	4,523 95	16,719 99	248
Detroit & Mackinac	17,134 24	71,957 98	268
Detroit Union R. R. Depot & Station Co	1,079 30	26,104 04	2328
Duluth, South Shore	55,528 10	175,511 04	216
Fort St. Union Depot Co	8,177 30	30,670 70	275
Grand Rapids & Indiana	66,824 48	177,974 60	160
Wisconsin Central (Gogebic & Montreal)	1,001 32	6,403 81	539
Traverse City R. R	1,197 51	4,212 99	252
Grand Trunk Western, Chicago, Detroit, Canada Co	102,980 07	200,601 94	95
Grand Trunk Junction	8,335 48	29,332 62	251
Cincinnati, Saginaw & Mackinac	4,103 39	12,474 36	204
Detroit, Grand Haven & Milwaukee	32,032 99	102,078 00	215
Michigan Air Line Railway	2,665 75	9,434 12	262
St. Clair Tunnel Co	5,523 49	25,771 90	366
Toledo, Saginaw & Muskegon	3,251 80	10,789 12	231
Hecla & Torch Lake	5,905 21	5,945 72	.006
Lake Shore & Michigan Southern	37,429 95	152,120 42	336
Detroit & Chicago	514 44	3,875 96	653
Detroit, Hillsdale & Southwestern	1,123 29	11,796 39	958
Detroit, Monroe & Toledo	19,871 96	63,711 77	220
Fort Wayne & Jackson	1,767 66	10,773 32	510
Kalamazoo, Allegan & Grand River	4,634 31	20,344 00	509
Kalamazoo & White Pigeon	3,219 17	13,645 76	324
Northern Central, Michigan	2,722 19	15,166 80	494
Manistee & Grand Rapids	2,435 35	8,828 58	260
Manistee & Northwestern	7,365 40	25,279 00	241
Manistique Railroad	2,233 37	3,956 75	77
Mason & Oceana	482 36	1,467 10	223
Mineral Range	9,176 25	32,679 95	256
Michigan Central	235,092 83	508,056 82	111
Battle Creek & Sturgis	551 40	5,117 62	828
Bay City & South Bend	295 20	2,527 80	760
Canada Southern Bridge Co	48 00	5,955 60	1272
Detroit & Bay City	23,526 20	68,102 50	145
Detroit, Delray & Dearborn	87	842 60	967
Grand River Valley	9,526 55	26,630 07	175
Jackson, Lansing & Saginaw	42,450 88	78,697 01	85
Kalamazoo & South Haven	1,518 35	5,476 90	260
Michigan Air Line	8,134 33	33,537 16	314
Michigan, Midland & Canada	178 50	1,685 20	844
Toledo, Canada, Southern & Detroit	44,560 74	87,638 20	69
Minneapolis, St. Paul, Etc., S. M	20,938 50	94,577 95	356
Pere Marquette	195,102 11	491,022 98	151
Quincy & Torch Lake	1,076 10	3,794 26	262
Sault Ste. Marie & Bridge Co	916 83	7,168 55	659
Wabash Railroad	30,993 23	71,845 63	135

These computations show vividly the increased burdens to which the different roads were subjected by the new tax—an enlargement in payments amounting in some cases to a four-fold, in others to a twelve and in a few instances to even a twenty-three-fold increase over the exactions of the gross income tax. The data shows but little more than this, however, because through the unlikeness in the character and in the administration of the two taxes little or nothing may be safely inferred con-

cerning the justice to the different roads of the varying increases. The evidence is added, too, however,—although conclusive proofs of the facts were already everywhere conceded by those who were acquainted with the matter—that the income tax had been seriously inadequate in its exactions since none of the roads find difficulty apparently in meeting the increased obligations which are laid upon them by the more drastic property tax.

The taxation of agencies closely associated with railroads has been very plainly influenced by the nature of the levy upon this latter taxable. Such utilities as are typified by express companies, union station and depot companies, car loaning, stock car, refrigerator and fast freight companies, which like the railroads were originally levied upon with a gross income tax, became likewise with the railroads subject to the property tax when this method became the established method of the state.*[27] Nothing seems more certain either than that the remainder of these principal public service utilities—the telegraph and telephone lines—will shortly succumb to the new method of taxation—agitation in this direction having almost prevailed in several of the recent sessions of the legislature.

The influence of the reformed taxation of railroads upon the property tax as applied to general property has been most striking also, since even the most insistent champions of the higher taxation of railroads have come ultimately, in the interests of justice and through the necessities of the "average rate," to urge the taxation of all property at its full cash value. A permanent board of state tax commissioners which increased the assessed value of the property of the state by more than a third as we have already seen during the first year of its existence*[28] is one of the chief fruits from this insistence. The new railroad tax must certaintly, therefore, receive a full share of credit for the greater revenues which have resulted to the treasury through the use of the improved tax upon the utilities companies and through the more efficient taxation of general property.

*[27]Mich. Statutes 1901. Act No. 173.

*[28]Report of State Tax Commr. 1902, p. 101.

NOTE.—By Act 49, session of 1909, the tax was applied to telephone and telegraph companies. The full list of companies now subject to this tax is as follows: Railroad and union station and depot companies, express companies, stock, sleeping, refrigerator, fast freight and car loaning companies and telegraph and telephone companies. Express companies had been included in the list of public utility companies which were levied upon with an average rate as provided by the law of 1901—Act 273.

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CHAPTER FIVE.

THE DISPOSITION OF THE RAILROAD TAX: SUMMARY.

The railroad impost in Michigan is in effect a special tax—its proceeds having always gone to support the public schools. The explanation of this unusual disposition of the tax rests partly upon a necessitous arrangement which was made in the early history of the state and partly upon a zealous solicitude for public schools which has been felt always by the people of this commonwealth.

I. State Taxation for Local Expenditures.

The origin of the arrangement is the direct outcome from the "internal improvement" activity which the state experienced in its early history. The commonwealth had used the proceeds from the school lands—16th section in each township—in the construction of its internal improvements. The interest upon the resulting indebtedness—now known as the primary school interest—had for a time been paid from the general fund in the state treasury. But with the sale of the roads and the receipt of tax payments therefrom the suggestion is made by Auditor Bell—report of 1847—that these tax payments should be devoted to meeting the interest charges on the school fund. This would "only be proper" he declares "since these debts are largely chargeable to the internal improvement fund."*[1] The relations between railroads and schools thus entered into in 1847 was made permanent by the constitutional convention of 1850 and the further provision was added by this body that with the termination of the state's indebtedness all railroad taxes as well as all other specific taxes were to be devoted to public schools.*[2]

The application of the railroad taxes to the support of schools has been unstintedly praised—in early times as the most stable source of income which, in that period of disordered finance, the schools could have and more recently "since these corporations derived their power, their rights and their entire privileges from the entire state at large it seems reasonable that taxes derived from them should be applied to a fund created for the benefit of all sections of the state."*[3]

The reflex influence upon the railroad tax of applying its proceeds to the schools has proven almost controlling. Governor Pingree emphasizes this in his statement that "there is a potent reason against the local taxation of railroads and that is the custom of the state to devote these taxes to some portion of the school fund."*[4] A vital dependence of the schools upon this tax was felt, too, seemingly, by the Michigan legislators, when discussing the substitution of ad valorem for specific taxes in the taxation reform movement of 1896-1901, since not infrequently

*[1]Aud. Rep. 1847, p. 16.
*[2]Constitution 1850, Art. XIV. Sec. 1.
*[3]Gov. Pingree's Mes. 1899, p. 32.
*[4]Gov. Pingree's Mes. 1899, p. 32.

the assertion was made in these discussions that the endangering of the school support was the chief objection to making the desired substitution and to many this remained until the end an insuperable objection.*[5] The new tax, too, when finally adopted, though strictly ad valorem in character must still subserve the school fund in accordance with the provisions of the constitutional amendment which made the tax possible.*[6] Finally, a concrete illustration of the subjection of the tax to the schools is found in the successful suit of the Detroit school board against the state board of assessors to compel the use of a method of rate making which met with its approval by which the impost upon the railroads should be increased with a consequent benefit to the school funds.*[7]

Much as the application of the railroad taxes to the support of schools is cherished by the people of the state—stimulated as it is both by tradition and by a zeal for schools which in this commonwealth amounts to a passion*[8]—there is a constantly growing dissatisfaction with the arrangement. Fault finding has been especially sharpened by the enormous amount to which the fund for distribution among the schools has attained since the adoption of the new railroad tax.*[9] The amount has averaged during this time an annual sum greater than $3,500,000, or a per capita disbursement of more than five dollars for each child in the state. Indeed, a recent report from the department of public instruction shows that 1,296 out of the 7,276 school districts within the state receive each year larger disbursements from the state fund than they can lawfully use—have, in fact, so the report states, from $500 to $5,000 of primary school interest fund on hand which has accumulated during the recent years.*[10] The limit of helpfulness has been reached apparently when results like these become the rule.

From the purely administrative standpoint, also, the distribution of railroad taxes to the support of schools shows little that is commendable. Practically, the plan followed has always involved the assignment of these receipts to the various schools of the state in sums proportionate to the numbers of pupils to whom these schools were available. Higher state institutions have assignments, too, but upon a different basis of distribution and in amounts relatively insignificant. The custom here described develops also an administrative fault which has frequently been the source of complaint from state auditors that the state collects these taxes and distributes them to the districts, while at the same time, through the general property tax the districts are making return contributions of almost equal amounts to the state treasury.

But the chief defect, the one which outweighs all others in the distribution of railroad taxes to the support of schools is the absence of adequate accountability which prevails in the expenditure of these disbursements. The sum received by the locality is in the nature of a bounty from the state for the promotion of education and the looseness in regard to results, which seems characteristic of all bounties as com-

*[5]Sen. Jour. 1898, p. 126, 117, 121, 136, and many others.

*[6]Con. Amend. Secs. 10 and 11, Art. XIV.

*[7]Board of Education of Detroit vs. U. S. Board of Assessors, 133 Mich., p. 116.

*[8]"Intelligence of a high order characterized the population of this state. Already had the educational system been established which has grown into one surpassed by none in the world, and which has become a fruitful model." Rhodes' History of U. S., Vol. II, p. 48.

*[9]Something almost sensational and provocative of an unusual amount of adverse criticism upon the whole arrangement was the huge sum of $8,901,106 or $12 per capita which in 1906-7 constituted this school fund. This accumulation arose from the deferment on the part of the railroads until the court decisions of this year before making payments under the new tax.

*[10]Bulletin No. 20, Dept. Public Instruction, p. 6.

pared with other governmental disbursements, may be easily found here. The community is but slightly stimulated to increased effort in the interests of education by the receipt of this bounty since public education is already highly cherished throughout the state. On the other hand, the devolution annually upon the school district of a sum of money so large that in more than a thousand of these divisions it is in excess of what can be used not only entails actual waste of funds but furnishes a powerful temptation to the cupidity of the local recipients.

Nothing of equivalent advantage either to the state government can be shown as a resulting compensation for these large outlays. There is little of centralized control of schools in Michigan, and, with the exception of the requirement of a uniform number of months of school per year under licensed teachers and the exaction of reports from the various districts, centralized support bears few other fruits so far as the state government is concerned. In the interests of the schools many suggestions have been made for reform—such as the apportionment of the fund to the districts on the basis of the number of teachers employed,*[11] and the arbitrary division of the funds between the higher institutions of learning and the common schools so as to increase the portion of the former,*[12] but, although a remedy of some sort seems imperative any analysis of these curative proposals would naturally transgress the purpose of a study of this sort.

The equitableness of the distribution, which has been made in this state of railroad tax receipts, purely as a matter of distribution, is much clearer than is the worthiness of the administrative methods which have been employed. So taxably rich are railroads everywhere that the intrastate struggle between competing taxing jurisdictions for access to these properties has not been less keen than has been the inter-state rivalry for the same privilege. On the one hand the minor civil divisions penetrated by railroads submit their claims, that, through furnishing these properties with fire, police and other protection they, are entitled to reimbursement by a share in the taxes which accrue. The manifestly just demands of these local governments for some returns from a property which entails—in cities at least—high public expenditures is reinforced by the well known compulsion which rests upon these governments of devising new ways for securing more revenue.

From the state governments, however, the railroads receive supervision which is constantly becoming more minute and more expensive. The roads have valuable property, too, which cannot be easily localized for taxation, and, besides, they are granted corporate franchises and other valuable privileges by the state. Upon grounds like these the state bases a just claim to revenue from these great properties.

The outcome in most of the states of this rivalry among the political divisions has been a compromise by which the state assesses the railroads, and, subsequently, apportions their assessed valuations to the minor political divisions where the tax is imposed, collected and its proceeds expended. A less one-sided settlement is found in some of the chief railroad states whereby the minor civil divisions collect a revenue from

*[11]Bulletin 1620, Dept. of Public Instruction, p. 6.
*[12]Gov. Warner's Message, 1907, p. 35.

such railroad property as is easily localized while the state collects from the franchise or "corporate excess" values and from the more general kinds of property. In a few of the states, also, which have been sufficiently untrammeled by tradition or constitutional restrictions as to separate the sources from which the local divisions and the state secure their revenues the whole income from the railroad tax has gone to the central government. This arrangement, when practicable, satisfies fairly well the claims of justice since the local divisions are freed from the burden of state taxes while the benefits from the state government are so widely distributed that all citizens receive a share. None of the commonwealths whatsoever in which there are railroads enough to make the matter of moment have escaped this problem of the proper distribution of the receipts from these great taxables, and, in all of them, one or another of the plans just described has been, eventually, the method which has been chosen.

The plan of distribution is indeed of vital importance to the commonwealth in its choice of imposts, since few instances of greater tenacity can be found than those shown by the hold of the beneficiary of a tax upon the source of its subsidy; nor many instances of livelier activity than is shown by this same dependent in shaping its support to its own interest.

Michigan from the first has permitted no taxation of railroads by any other than the state government, and, in this respect, her method has been identical with that of the states in which there is a "segregation of sources as between the local and the central governments. Contrary to the practice of these states, however, the distribution of these tax receipts in Michigan, as we have seen, has been to specific localities,—i. e., the school district—rather than a general distribution through the benefits which are commonly derived from a state government. Does a plan of this sort—state taxation for local expenditure—conserve the rights of the different jurisdictions? Does it properly satisfy the just claims of the different governments to shares in the taxes drawn from railroads?

The handling of railroads in Michigan from a fiscal standpoint—state taxation for local expenditure—illustrates a principle of constantly growing usefulness in cases where public income must be collected from properties by the centralized or "unitary" methods of tax administration in order to insure proper treatment, but upon which, also, a dependency is still felt by the local governments for support. The properties imposed with a specific or corporation or license tax or, in general, those taxed by a state board are the typical ones of which this situation is true and in the taxing of which this principle is most plainly applicable. But the practice of state administration for local uses—"division of yield" as it is sometimes called—is also pertinently suggested for use in states where there is a "segregation of sources," as a remedy for the fatal "non-elasticity" which the separation of state from local taxation customarily develops in the revenues of the centralized government.*[14]

The plan lays no claim to novelty, since centralized methods of taxation for local expenditure have been widely practiced abroad, while every essential characteristic of the "division of yield" scheme may be found in the well known "surplus distribution" of the Federal government in

*[14]Seligman Columbus Tax Conference, Nov. 1907.

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1837, but it is the contemporary growth in the numbers and magnitude of the properties to which the plan is applicable which causes its present importance.

Useful as the method is and increasingly useful as it is in promise the theory upon which "divisions" should be made is not at all developed if indeed a theory is conceivable where the usual application of the scheme is to taxes with pronounced individual peculiarities. The "divisions," however, must be obviously two fold in number—one which will separate the portion of the tax receipts which goes to the state from that which goes to the localities, and, another, which will make a distribution among the localities. No principle, which may be generally used, is readily apparent which will arbitrate between the state and the localities, but, in the adjustment of the claims of the minor political divisions, two basing points at least of apportionments may not be neglected with propriety. These are the situs of the owner of the property taxed and the situs of the property itself.

The selection of the property-location basis of apportionment is approved because, customarily, it is at the place where property is situated that the expenses of its police and fire protection, street traffic facilities, building privileges, etc., are incurred and there seems no warrant in justice that any property which is benefited should escape its share of burdens of this sort. A complete endorsement of this basis is made by Mr. H. G. Friedman in his study of the corporation tax in Massachusetts by the assertion that "the limits of the community correlated with a corporate industry should be the confines within which the tax is expended."*[15] On the other hand the choice of the owner's situs as the determinant of the place where the tax receipts shall be expended has only the single merit that it is in harmony with the usual situs principle which governs in the taxation of other personalty, namely, that personalty follows the situs of its owner.

The Michigan plan of "yield division" was shaped by the practical needs of the state school system and by the accidental relations between this system and the railroad building fund and was uninfluenced by any theory of division whatsoever. The plan has been much more moulded by the presumed needs of the schools than by any considerations affecting the equitable distribution of the railroad tax receipts, but, while of an accidental character, as we have seen, it harmonizes measurably with the requirements of good theory in its methods of distribution among the localities.

The plan of apportioning railroad tax receipts to school districts in accordance with the number of children of school age within the district naturally favors the more populous city school areas as compared with those of the country. As illustrative of this situation the records of the superintendent of public instruction show that in 1907 one-quarter of the school fund was distributed to ten of the largest cities in the state, and, of these, Detroit alone received approximately a half million or one-seventh of the entire amount of these tax receipts.*[16] But it is in these cities that the charges for caring for railroad property falls the heaviest upon the public and it seems in accordance with equity that in these political divisions the largest amount of benefit from the school

*[15]Corporation taxes in Mass. page 73, H. G. Friedman.
*[16]Computation in the office of Superintendent of Public Instruction.

fund should be received. It seems not improbable that some one of the many attempts to establish the local taxation of railroads in Michigan*[17] would long since have been successful were it not for the real though rough measure of justice which this scheme of "yield division" provides through assigning to the cities and villages a larger portion of the school fund than is received by other divisions of the state.

"The divisions of yield" between the localities and the state, which has just been mentioned, as the first of the two "divisions" which must logically be made, is also not without recognition in the Michigan plan. The rule seems an invariable one among the commonwealths that some contribution shall be made to the support of the local schools from the commonwealth government itself. None of the commonwealths, indeed, oblige the schools to rely wholly upon the locality for support. An obligation of this sort resting upon the Michigan government must have been met by taxation of some sort and the responsibility seems not inadequately administered when the amounts which should go to the state as its share of railroad tax receipts are made use of to constitute the contribution which the state makes to the support of public schools.

The whole scheme, however, has not gone unscathed from adverse criticism, especially from public officials of the state. Governor Rich urges in 1897 in the interests of the state treasury that if the constitution should be so amended "as to permit specific," i. e., railroad taxes, "to be put in the general fund an amount sufficient to provide for the wants of the state government, well, could be raised in a manner much more equitable and less burdensome to the people than by the present method."*[18] And a recommendation of similar tenor is made by Auditor Stone in 1891 in the interests of improved administration that "the constitution should be so amended as to permit the use of surplus specific" (railroad) "taxes by the state."*[19] Auditor Dix in 1900 asserts "that many complaints had reached him concerning the use of the specific" (railroad) "taxes in the support of schools,"*[20] and this assertion is supplemented by a lengthy discussion showing the unjust irregularities in the subsidies to the different counties which result from the Michigan method of distribution.

An interesting speculation arises, in view of the wide popularity enjoyed by the much discussed "segregation-of-sources" tax reform, concerning the aptitude which is created by the existence of the state or unitary tax upon public utility corporations in Michigan for the "segregation" of these taxes to the support exclusively of the state government in this commonwealth. The close equivalency in amounts between the collections of specific taxes by the state each year and its disbursements for state purposes has inspired not a few suggestions that a separation of "sources" should be adopted in Michigan. Attorney Gen-

*[17]See account of efforts in this direction:
Judge Goodwin's Memorial from the City of Detroit to the Constitutional Convention. Convention Jour., p. 689 and 769.
Report of Legislative Com. of 1875. House Jour. 1875, Vol. 2, p. 991.
Petition and arguments from Common Council of Detroit. House Jour. 1891, p. 3591.
*[18]Gov. Rich's Message. Sen. Jour. 1897, p. 22.
*[19]Aud. Report 1892, p. 49.
*[20]Aud. Report 1902, p.

NOTE.—The school interest fund since the adoption of the ad valorem railroad tax receives contributions to the amount of 90 per cent from the railroads. The remainder is contributed by express companies, telephone or telegraph and insurance companies. None of these being local in the nature of their expenses or support it is not unreasonable to group them with railroads.

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eral Oren in particular urged this plan upon the board of equalization in 1901,*[21] and again upon the legislature in the same year,*[22] and Auditor Stone commended the separation of sources in his report of 1892 when urging the use of the specific taxes for the support of the state."*[23]

The reform may be said to have had, however, but few advocates in Michigan. In the recent constitutional convention (1907-8) "segregation of sources" was at no time advocated throughout the entire session. Not to speak further of the excessive sensitiveness of the people of the state to legislative interference with the school fund—and interference would be necessary, naturally, before the plan of using railroad and specific taxes for state purposes could be changed—the state has gone far in the direction of the centralized administration of taxation through a state board of taxation, and reform may seemingly be more hopefully expected through strengthening this board than through a larger decentralization of the system.

II. Centralized Administration.

The characteristic, which has been most distinctive in the taxation of railroads in Michigan, has been unquestionably the persistence of centralized administration. The taxing of the roads and the collection and distribution of the proceeds has rested wholly with state officials in this commonwealth from the beginning—local taxation of these properties having never at any time obtained.*[25] The plan of administering railroad taxation by central authority commands approval everywhere and is one which nearly all the states have striven to acquire. Its merits may be briefly summarized as follows,—an economical and efficient administration of the tax, uniformity in the treatment of the roads and the establishment of a taxing authority which is co-extensive with the business activities of the taxable.

The adoption of this excellent method in Michigan, as has been shown, was the accidental outcome of the ownership of the original roads by the state and its permanent establishment resulted not only from an appreciation of its intrinsic worthiness, but, also, through the identification of these taxes with the specific taxes and through the use of their proceeds by the schools. The plan has received the unvarying approval of railroad commissioners, governors and other public officials interested in its administration and indeed its practical merits have fully equaled the expectations which the student in administrative theory might have formed. "There would be no advantage but perhaps detriment," says Commissioner Innis (1883) "from a change in the method of taxing our railroads, a conclusion which the last legislature seems to have reached, as, after an exhaustive consideration of the subject, a bill providing for the substitution of local taxation in lieu of specific" (unitary) "it was defeated by a decided vote."*[26] And from Commissioner Rich in 1889,

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*[21]See Rep. of Board of Equalization 1891, p. 265.
*[22]House Jour. 1901, p. 641.
*[23]Aud. Rep. 1892, p. 49.
*[25]Michigan shares with Pennsylvania, apparently, the distinction of being the only states within the union in which the local taxation of railroads obtained no foothold.
*[26]R. R. Com. Rep. 1882, p. 32.

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"Our plan for the taxation of railroad property has provoked extended discussion in recent legislatures, and the constituencies of the large cities, as a rule, favor the adoption of local taxation—it is not probable, however, that the change from specific" (unitary) "taxation would give general satisfaction among the communities of the state."*[27]

In addition to the general benefits which have just been mentioned, the taxing of railroads by central authority in this state has favored experimentation in the search for an ideal system for collecting a revenue from these properties. The commonwealth has had a free hand in varying its methods of railroad taxation which it would not have enjoyed had the interests of the localities been involved. "The fear of antagonizing local interests has inclined legislatures to permit taxing districts to continue the taxation of railroads," says the Wisconsin tax commission of 1905, "and the opposition to surrendering local power as well as the sources of local power defeats rational and scientific laws for the taxation of local property.*[28] The commonwealth has utilized three entirely distinct methods in collecting a revenue from railroads and in none of these has serious hindrance to a full test of merits been felt through opposition from the localities.

A second benefit which has resulted from centralized administration in Michigan has been the avoidance of the multiple taxation of roads which is so common even among those states which are richest in these utilities. It is, of course, easily conceivable that the levying of one tax upon the franchises of a road and another upon its physical property, and still another upon its income may be so administered—at least when by a single authority—as to present an unexceptional impost and systems of this sort at any rate are to be found in several of the states though the conclusion seems unavoidable that in the rapidly changing economic conditions of the times such multiple taxes must prove awkward of adjustment when changed circumstances demand changed taxes.

The persistence of centralized administration in this state did much to familiarize people with the treatment of railroads as wholes in the matter of taxation, and in this way the adoption of the unitary method of assessing these properties was facilitated, when, as the result of the "equal taxation" reform, the employment of the property tax was rendered desirable. The keynote to this now widely used administrative detail is the insistance that railroads shall be assessed as going concerns and that they are productive entities—therefore valuable—only as the property as a whole is taken together. The avoidance of the evils which result from apportioning the roads out to the localities for assessment and also those which result from omitting some railroad element—usually "good will" or "corporate excess"—from the assessment is accomplished by means of this unitary method.

Finally the general acceptableness throughout the state of the valuation which was determined by the "great appraisal" and which was obtained by recognizing all the elements which enter into a railroad property sustains the assertion of popular familiarity in Michigan with the notion of dealing with railroads as wholes.

*[27]R. R. Com. Rep. 1889, p. 42.
*[28]Rep. of Wis. Tax Com., 1903, p. 151.

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III. Merits of the Property Tax on Railroads.

The changefulness of systems of taxation in Michigan is in marked contrast with the permanency of the scheme of administration which has just been described—the capitalization tax giving way to the one on incomes and this in turn being supplanted by the property tax. It exceeds the possibilities of demonstration doubtless—owing largely to differences in conditions and in taxing ideals—to show that there has been a uniform progression of merit in this succession of methods, but the property tax shows points of superiority over its predecessors which are worthy of consideration at this place.

The most obvious benefit which has resulted from the adoption by the state of the property tax upon railroads is the simplification of the taxation process throughout the commonwealth. All the principal taxables throughout the state are now subject to the property tax principle. Such an uniformity of methods in collecting its revenues must certainly profit a commonwealth when, as the result of a new economic order—say the supplanting of an agricultural economy by manufacturing—or as the result of new governmental burdens, it becomes necessary to readjust its fiscal arrangements.

Readjustments of this sort have occurred periodically in Michigan—once in 1881, when a tax commission was appointed to revise the state tax laws,*[29] again in 1891 when a mortgage tax law was adopted,*[30] a new method of collecting taxes was devised,*[31] the tax on mines was made a local tax*[32] and a new railroad tax was enacted,*[33] and finally the one of 1896-1901 when the reform legislation was adopted—and the recurrence of tax commission after tax commission in other states suggests that with them the case is not different. In such periods of popular discontent with tax conditions the well known and simple system of taxation must be vastly easier of adjustment than is a system composed of various taxes. The expensive appraisal of the Michigan railroads—the "great appraisal"—is illustrative of the money cost which must sometimes be borne by a people in reducing their different taxes to an equivalent basis.

The equality in taxation which is so commonly regarded as the Alpha and Omega of justice in this process finds, too, its most popular measure in the use of "uniformity" in rates, methods and bases for all taxables. The reform movement in Michigan which rallied under this watchword of "equality" might apparently with equal propriety have adopted the phrase "uniformity of taxation" as its slogan. "I have always contended," said Governor Pingree in his ex-augural message, when replying to the assertion that equal taxation was obtainable through increasing the specific rates on railroads, "that whether they" (the railroads) "were paying their share or not, the property of these companies should be taxed the same as other property is taxed, namely, upon an assessment at its cash value."*[34] The eventual substitution of the property tax for the specific railroad tax—as an alternative to the plan of procuring equal taxation through raising the specific rates—is the well

*[29]Report of this Com. House Jour. 1882, p. 28.
*[30]Laws 1891, Act 200.
*[31]Laws 1891, p. 292.
*[32]State Laws 1891, Act 139.
*[33]State Laws 1891, Act 174.
*[34]House Jour. 1901, p. 24.

known sanction with which the people of the state endorsed the governor's contention.

The history of these two taxes (specific and property) in this state warrants indeed the conclusion that a strong popular dislike prevails with regard to exceptional taxes since the early declaration from Justice Campbell that "the property tax must be the rule, specific taxes the exception," has been amply justified by the course of development. The absorption into the general property system of one after another of the specific taxes, which was noticed on an earlier page, seems to presage the ultimate mastery of the field by the property type of impost. This outcome is the result, too, not only of the favor with which the property tax is popularly regarded, but also of the dislike which is commonly felt for the extraordinary in government. The special charters, for example were avowedly confiscated by the state on account of the special privileges which they conferred, and the imputation of special privilege stirred much of the feeling which was eventually directed against the specific system of taxing railroads.

Nothing is more demonstrable, certainly, than the fallaciousness of the claim that uniformity in taxation gives equality—at least the "equality" which is measured by the "residum of property," or other familiar tests which are so well known to the student of taxation. The principle is well established, also, in the conclusions of our courts that, even, when equality is a matter of constitutional requirement, it does not imply uniformity in method. But taxation subtleties were little dealt with by the "equal taxation" reformer, and it was broadly assumed that equality in results would follow from similarity in methods. No other tax carries such prestige with the American public as that of the tax on property, and, to the extent that public sympathy must be lured and won in order to make an impost successful, no other tax may be so profitably employed as the one which taxes property. The approval of public opinion is a support which in fact no tax may enduringly disregard. Even "an unfounded belief," Bastable declares, "that the public burdens are not fairly divided among the different classes and individual members of a society, is a seriously disturbing force."*[35] The complacency of the taxpayer seems cheaply purchased, then, when procured at the price of establishing an uniform system of taxation even though the extension of the unscientific general property tax is necessitated by the achievement.

The comparative openness which marks the administration of the new tax is also a merit which deserves thorough approval. The annual taxing of the railroads by a board of assessors is almost necessarily a conspicuous occurrence, and, while all have not risen to the importance of an "event" in Michigan as did the one in 1905, when the Galbraith law was involved, yet no execution of this duty by the board has gone unnoticed by the press of the state. In one case this open or public method of administering the tax gave a school board, in another the attorney general, the opportunity of rectifying the levy in the interests of equity. Useless as publicity may be in the case of some taxes, if, indeed, not positively harmful, its serviceableness admits of little questioning when revenue is to be secured from two properties concerning which there is so much enduring jealousy as between railroad and general property.

*[35]P. 275 Pub. Finance.

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A closely allied merit to the one which has just been described, is the assignment to the new tax of a specialized board by which it was to be administered. Nothing is at first more mystifying to the student than the seeming indifference and real hesitancy of successive legislatures toward increasing the tax on gross incomes while other taxables were so evidently bearing increasing burdens. The explanation seems obvious that there was a lack of responsible initiative with regard to railroad taxation in a body so numerous as is a state legislature. Railroad taxation was the especial business of no one in a body of this sort and therefore received no especial attention until abuses became so manifest that they could no longer be ignored. The new tax on the other hand is represented before the public by this specialized board, and, besides benefiting the administration of the tax with the usual advantages which flow from specialized treatment, a public standing is given to the exaction in keeping with its importance through thus being intrusted to a special branch of government for administration. The determinate, educational influence which this board exercises is indeed of no small moment as the single instance of the work performed by the board reports may show. These transcripts of the data from which the tax is determined—mere by-products from the activities of the board—together with studies into the conditions which affect this data are published biennially and supplant admirably the services of the well known reports from the periodic tax commissions which the necessities of tax reform compel other states to provide. It is in fact a belief easily credible that the continued presentation of such information as is found in these reports should so inform the public mind and adapt it to the development of proper methods of taxation as to forestall permanently the recurrence of the turmoil and expense of another "equal taxation" struggle.

The new tax and its accessories, the ad valorem assessment processes and boards of assessors, commands approval also through harmonizing with the railroad taxing systems of other states. Most of the American states use a method similar to the one which has been adopted by Michigan and there are incontestable benefits to be derived from uniformity among all the states. The roads—now largely interstate lines—benefit through being obliged to familiarize themselves with but one system of taxation and through being freed from the temptation of playing off states levying on earnings against states collecting from property, assigning to the first their property, to the second their earnings. Michigan is benefited by having an easily applied test of the justness of her own impositions upon railroads by simply comparing them with the levies made upon the same roads by identical methods in other states. Few, indeed, are the illustrations, which are more forcible, by which the contentions of those publicists, who believe in a stronger informal union among the states, are supported than are those which show the benefits derivable from the uniform taxation of railroads.

But it is the tax itself, or, more familiarly "rate" which bids fair to be the most enduring product of the taxation reform. The nurturing of the idea—mainly through the supreme court decisions—that the elements which enter into the "average tax" or rate must be *real* elements and not as the state board of assessors contended, a mixture of real and "equalized" ones has done much to give body to the impost and to establish it with the public. The action of the board received, indeed, no

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uncertain condemnation from the public when, in trying to apply the Galbraith law, a tax was levied upon the railroads which was different from the average of taxes levied upon general property. An "average rate" savors of impartiality to the public through being the average of all the taxes levied throughout the state. The many and divergent sources from which its components are collected—levyings of hundreds of local officials upon locally made assessments, and impositions from legislatures and county and city boards—removes apparently all taint of biased or improper influences from its make up.

The use in Michigan of an apportioned general property tax instead of the rated one so customarily employed in other commonwealths, develops superlative material for an average rate or tax. The apportionment of the public burdens as compared with rating them is a more direct way of measuring the burden levied against the contributing property and seems commendable of itself. But the debt, however, of the Michigan railroad impost to the apportionment scheme is for the thousands of judgments both as to tax burdens and tax bases which a system of apportioned school, township, county, village, city and state taxes must involve. These judgments reflect the data from which the "average tax" is composed and the sense of arbitrariness so easily associated with rated taxes or their derivatives seems foreign to a tax like this. The impost fluctuates directly with the increases or decreases of taxation upon other property. The farmer and the merchant finds that when the annual levy is heavy upon him it is heavy upon the railroad also and this smacks of the "equality" which was so largely the inspiration of the tax reform.

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INDEX.

Assessors, State Board of, 39; merged with Tax Commission, 44; character of membership.. 48
Assessments, in Michigan, of general property, 51, 52; of railroads........ 45–49
Atkinson Tax Bill, proposed........ 36
Centralized Tax Administration, beginnings in Michigan, 15; nature of........ 63-65
Charter Roads, origin of, 9–10; action of, 14–17; tax receipts from, 18–19; objectionableness of, 20, 38; repeal of........ 11–12
Detroit School Board Case, influence of........ 51
"Division of Yield" Taxation Principle, use of in Michigan........ 60–62
"Equalization" Question, importance of, 43; difficulties of........ 50–53
Equalization, State Board of, establishment of, 12; report on panic of "93"........ 34
"Equal Taxation" Reform Causes, 33–35; results........ 35–39
Express companies subject to the property tax........ 56
Franchises, taxation of........ 40–41
Galbraith Law, enactment of........ 52
Gross Income, definition of........ 23–24
Internal Improvements, account of........ 9–10
Interstate Commerce, opposition to, 17; taxation of........ 25
"Land Grant" Bounties, importance of........ 10
Localization Problems, as between active and collateral railroad property, 23; interstate commerce........17, 25, 39
Lord Bill, nature of........ 53
Merriman Law, adoption of........ 37
"Michigan Appraisal" of Railroads, reasons for, 39; influence upon railroad assessments, 40, 47; influence upon equalization, 50; comparison of, with assessments........ 49
Michigan Central Railroad, charter provisions, 13; full capitalization of........ 19
Multiple Taxation of Railroads, avoidance of in Michigan........ 64
Municipal "Aid", stimulus of to road building, 10; character of........ 21, 22
Panics of 1837, 9; of 1893........ 34
Pingree, Governor, taxation message, 35; message on school fund, 57; taxation reform leader, 39; ex-augural message, on equal taxation........ 65
Primary School Fund, relation to specific taxes, 13; origin of, 57; relations to tax reform, 57–58; to railroad taxation, 59; criticisms of........ 59
Rate of Taxation, upon general property, 12; as between charter roads and general property, 18–19; as between gross income taxed roads and general property........ 33
Railroad Assessments, legal requirements, 40-41; method of, 45-48; history of........ 48–49
Reports from Railroads, under the capitalization tax, 17–18; under the gross income tax, 30–32; under the property tax........ 41, 46
Segregation of Sources, inadequacy of, to solve equalization problem of railroad taxation, 53; status of, in Michigan........ 62
"Situs" Problems in Railroad Taxation, significance of, 42; as to benefits and responsibilities, 59; as a basis of "yield" apportionment........ 61
Specific State Taxes, character of, 12–13; opposition to, 65–66; to support the state government........ 62
Tax Commissions, commission of 1881, 65; mandatory tax commission of 1899........37, 50–51
Tax Rates, under the capitalization tax system, 14; gross income tax rate, 26–30; the "average rate," 41–43........50–53, 66–68
Tax Readjustments in Michigan, dates of........ 65
Tax Reviews, provisions for, 41; results of first........ 46–47
Tax Statistician, appointment and duties of........ 34
Telegraph and Telephone Companies, subject to the property tax........ 56
"Uniformity" in Taxation, demand for, 35; "uniformity" and "equality" of taxation, 65–66; between states........ 67

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