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TAXATION OF STOCK IN NORTH CAROLINA CORPORATIONS

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ON December 20, 1922, the Supreme Court of North Carolina, in *Person* v. *Board of State Tax Commissioners and A. D. Watts,*[1] upheld the statutory provisions exempting stocks in North Carolina corporations from taxation where such stocks were already taxed through the corporations themselves. The case is primarily concerned with methods of legal procedure, and the court was not presented with the necessity of determining constitutional questions. Nevertheless it deemed the matter of such paramount importance, since "the policy adopted by the legislature for taxing corporate property and continued with minor changes for well nigh half a century"[2] was assailed, as to merit the expression of an opinion. The court proceeded accordingly to settle once and for all the constitutionality of the statute exempting corporate stocks from taxation in the hands of individual stockholders, when such stocks in domestic companies are assessed and a tax paid thereon by the companies themselves.

The constitutional issues involved are relatively simple. The state Constitution provides "that laws shall be passed taxing by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise; and also, all real and personal property, according to its true value in money."[3] The Machinery Act specifies what shall be enumerated in the tax list of each individual taxpayer and definitely includes "money, investments, stocks and bonds, and shares of stock in incorporated companies which are not taxed through the corporation

[1] (1922) 184 N. C. 499, 115 S. E. 336. The scope of this article will not permit of a discussion of the federal taxes affecting corporations. It should be borne in mind, however, that a study of these taxes would show a correspondingly heavier tax burden resting upon corporate investments.

[2] 184 N. C. 507.

[3] Const. art. 5. sec. 3.

itself."[4] The Revenue Act of 1921 states: "Individual stockholders in any corporation, joint-stock association, limited partnership, or company paying a tax on its capital stock shall not be required to pay any tax on said stock or list the same, nor shall corporations legally holding capital stock in other corporations in this state, upon which the tax has been paid by the corporation issuing the same, be required to pay any tax on said stock or list the same."[5] The constitutional question was, do these provisions in the law conform to the mandate laid down in the Constitution? The court decided in the affirmative.[6] The gist of its utterance is found in the following quotation: "The purpose of this language [that of the statute] was to exempt from taxation in the hands of individual stockholders certificates of stock in incorporated companies, where the state had already exercised the right to tax such stock through the corporation itself, or 'at its source' as it is sometimes called. Manifestly, so far as the constitutional mandate is concerned, it is immaterial whether the legislature impose a uniform tax on such instruments in the hands of the individual shareholders or levy and collect such a tax through the corporation itself. The method to be employed is one involving a question of statecraft to be determined by the legislature, and not for the courts to decide. Our functions are judicial, and we have no power to levy assessments or to devise a scheme of taxation."[7]

Two basic theories are presented in the case concerning the taxation of corporate investments. The first theory, adhered to by the plaintiff and Chief Justice Clark, is that the statutory method of taxing the shares through the corporation is an evasion of the Constitution; and that, while the corporation should pay a tax on its capital stock, the shareholders also should list and pay a tax on their certificates of stock, since such certificates are the individual property of the stockholders and are separate and distinct from the property of the corporation. The second theory, adhered to by the defendant and the court, is that, while in a restricted sense the property in the form of corporate stocks owned by the shareholders is distinct from the property owned by the corporation as a legal entity, the shares of stock are actually returned for taxation, and have been for years, by the proper officer of the corporation on behalf of the owners and the tax paid by the company, the situs of the shares for taxation being changed from the domicile of the owners to the domicile of the corporation; that all shares of stock, owned by residents and non-residents alike, are thus subjected to the same burden of taxation; and that this method of taxation eradicates the injustice of double taxation.

Since the plaintiff and Chief Justice Clark in upholding the first theory allege that the holders of corporate stocks escape from all taxation, it is necessary to analyze very briefly but nevertheless carefully the existing system of corporate taxation in North Carolina. How are North Carolina corporations taxed? What

[4] P. L. 1921, ch. 38. sec. 40 (21).
[5] P. L. 1921, ch. 34. sec. 4.
[6] Justice Adams wrote the leading opinion. Justice Stacy wrote a concurring opinion in which Justices Hoke and Walker joined. Chief Justice Clark wrote a vigorous dissenting opinion.
[7] 184 N. C. 514.

kinds of taxes are they compelled to pay? They are compelled to pay four different kinds: (1) an incorporation tax or fee; (2) an annual franchise tax; (3) an *ad valorem* tax on real and personal property, including the capital stock, good will, choses in action and all other property of every sort, whether tangible or intangible; and (4) an income tax on net corporate incomes.

The incorporation tax is a fee which must be paid in securing a certificate of incorporation from the state.[8] It is often called an organization or charter tax. When a certain number of individuals desire to do business in a corporate capacity, they apply to the Secretary of State for a charter, and are required to pay forty cents for each $1,000 of the total amount of authorized capital stock. In no case may the amount be less than $40. Likewise, the same rate applies after incorporation when there are increases made in the capital stock. If the certificate is amended for other reasons such as changing the name of the company or the nature of the business or increasing or decreasing the par value or number of the shares, $40 must be paid. In case of a change of the principal place of business or in case of dissolution, a fee of $5 is required.

In addition to the organization tax, there is an annual franchise tax on domestic corporations.[9] This is one-tenth of one per cent assessed upon the subscribed or issued and outstanding capital stock. In no case is the amount to be less than $10. This tax is a state tax in contra-distinction to county, town or city taxes and is levied and paid every year. It is a general and not a specific tax, and must not be confused with specific franchise taxes imposed on banks, railroads, express, telephone and telegraph companies, insurance companies and certain other enterprises.

Moreover, North Carolina corporations are taxed on the value of their property including their capital stock, good will and all other intangible values. In so far as the real and personal property is concerned, this tax is like any other *ad valorem* tax, and is assessed in the same manner as the tax on the real and personal property of individuals and partnerships. The property is listed by the president, cashier, treasurer or some other person delegated by the corporation to act in this capacity,[10] and is placed on the tax books in exactly the same way as other property.

With regard to the assessment of capital stock the method of procedure is quite different.[11] The law requires the president, chairman or treasurer of every corporation to report in writing to the Commissioner of Revenue on or before the first day of July of each year: the total authorized capital stock, the total number of shares authorized, the number of shares issued, the par value of each share, the amount of capital stock paid in, the amount of capital stock on which dividends have been paid with the date and amount of each dividend, the highest price of sales of stock between the first and fifteenth days of May, the highest price

[8] C. S. ch. 22, sec. 1218.
[9] P. L. 1921, ch. 34, sec. 82.
[10] P. L. 1921, ch. 38, sec. 31.
[11] P. L. 1921, ch. 38, sec. 43, 46.

during the year, and the average price during the year. The officer making the report estimates and appraises the capital stock of the company at its actual cash value on the first day of May, "after deducting therefrom the assessed value of all real and personal estate upon which the corporation pays a tax, and the value of shares of stock legally held and owned by such corporation in other corporations incorporated in this state and paying taxes on its capital stock in this state, as indicated or measured by the amount of profits made, either declared in dividends or carried into the surplus or sinking fund."[12] Every corporation may also deduct from its capital stock, surplus and undivided profits, its actual investment in the bonds of this state, the bonds of the United States and the bonds of Federal Farm Loan Banks and Joint Stock Land Banks.

When this report is sent to the Commissioner of Revenue, the Commissioner has the power, if not satisfied with the appraisement and valuation, to revise the valuation, the corporation having the right of a hearing and an appeal to the courts. The Commissioner then certifies the taxable value of the capital stock, or rather the amount of the excess over the deductions, to the registrar of deeds in the county where the principal office of the company is located, and the amount is added to the listed value of the corporation's real and personal property under the name of the corporate excess, and is assessed at the same rate as other local property. Since "no tax on any property in this state shall be levied for any of the uses of the state government,"[13] the *ad valorem* tax on corporations, including the capital stock, is strictly a local tax and not a state tax, and the rate of taxation varies with the several local subdivisions of the state government.

Finally, incorporated concerns in North Carolina are compelled to pay an income tax on their net corporate income.[14] This tax was provided for in the Revenue Act of 1921 and was to apply to incomes received during 1921, such tax to be paid in 1922. The tax is levied at a flat rate of three per cent on the entire net corporate income. By net corporate income is meant the gross income minus deductions allowed. The allowable deductions are: wages of employees and salaries of officers; rentals; interest paid on indebtedness; taxes for the income year, except local taxes of a kind tending to increase the value of the property assessed; dividends from corporations paying an income tax in the state; losses incurred, if uncompensated by insurance; bad debts charged of; charges for depreciation and depletion; reserves for contingent liabilities; and contributions to charitable organizations. There are no further exemptions permitted, such as personal exemptions in the case of individuals. Corporations with less than $1,000 net income are not required to make a return. Dividends distributed by incorporated companies after they have paid the flat rate of three per cent on their net income are not taxable as personal income in the hands of stockholders.

Since domestic corporations in North Carolina are amenable to four different forms of taxation under the existing system of corporate taxation, it does not

[12] P. L. 1921, ch. 38, sec. 43.
[13] P. L. 1921, ch. 34, sec. 3.
[14] P. L. 1921, ch. 34, art. 2, 3, 4; P. L., Ex. Sess. 1921, ch. 102.

seem quite consistent to argue as do Chief Justice Clark and the plaintiff that corporate stocks held by individual shareholders escape from all taxation. Even though the shareholders are not directly taxed, they can not be considered as occupying a totally tax-free status, since the corporations have paid their taxes for them and since the amounts paid would otherwise have come to them had the state not levied upon the corporations.

But to get back more specifically to the points at issue, what are the advantages of exempting stocks in North Carolina corporations when such stocks have been taxed through the companies themselves? The advantages are: (1) that the exemption conforms to the state's permanent policy in taxing corporate property; (2) that it is in accord with the policy of other states; (3) that it restrains stockholders from dodging taxation through failure to list their shares; (4) that it provides for the taxation of resident and non-resident stockholders alike; (5) that it makes possible a saving in the costs of tax collection; (6) that it stimulates the permanent investment of capital in the state; and (7) that it prevents double taxation.

That the statutory method of taxing stocks through the incorporated enterprises themselves conforms to the state's permanent policy in taxing corporate property is easy to prove. Even Chief Justice Clark himself admits that the policy dates back to 1887. He says: "The thin edge of the wedge exempting any stocks from taxation introduced in 1887 was gradually made broader, until, by the act of 1919, it was made to exempt the stock of all corporations chartered in this state, or whenever two-thirds of their property, though chartered in other states, was taxed in this state."[15] For short time prior to 1887, or from 1873 to 1887, the policy was somewhat different.[16] During this period, stocks in the hands of individual shareholders were taxed as personal property. But prior to 1873, and even as far back as 1860, the method of taxing stocks was the same as at present. Thus, the statute exempting stocks taxed through the corporations is in conformity with the state's policy followed continuously for sixty-three years with the exception of about fourteen years between 1873 and 1887.

The policy of taxing stocks through the companies issuing them is in accord with the policy of other states. While the constitutional requirements are somewhat different in many cases, yet there are more than forty states which follow the same policy that the General Assembly of North Carolina has followed.[17] Professor Seligman says: "In some states the tax on the corporation is declared to be a tax on the shares, which are accordingly exempted from assessment. Thus

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[15] 184 N. C. 525.

[16] For example, the act of 1873 required the individual stockholder to list "stocks in national, state and private banks, and stock in any incorporated company or joint-stock association, and their estimated value." P. L. 1873-74, ch. 133, sec. 9 (6). This policy was continued with modifications until 1887, as reference to the various acts will show. But back of 1873, the statutes indicate that stocks were taxed through the corporations themselves. For instance, according to the act of 1860, "the stock or interest held by individuals in all corporations, excepting banks, shall not be listed or assessed among the individual property of the stockholder, but shall be listed by the corporation, and the corporation shall pay the tax thereon." P. L. 1860-61, Second Ex. Sess. ch. 31, sec. 5. According to the act of 1868, the tax list shall contain "stocks in any incorporated company or joint-stock association, and their estimated value, but the stock shall not be taxed if the . . . .company pays a tax." P. L. 1868-69, ch. 74, sec 12 (6).

[17] For an enumeration of the states, see Justice Stacy's concurring opinion, 184 N. C. 518. Likewise, there is an enumeration of the states in *The North Carolina Corporation Code*, Atlanta, 1922. p. 501.

in California, the statute declares that shares of stock possess no intrinsic value over and above the actual value of the property of the corporation for which they stand and that to tax both corporation and shareholder is double taxation. In Arizona, we find exactly similar language used. In most of the other commonwealths, also, shares of stock in the hands of individuals are exempt when the corporation itself is taxed."[18] Judge Stacy, in his concurring opinion, says: "So far as I have been able to ascertain, no state in the American Union has adopted and carried into actual practice the policy advocated by the plaintiff in this suit."[19] Consequently, North Carolina's system of taxing corporate shares parallels essentially the systems adopted in other states.

The statute collecting the tax on stocks from the corporation restrains individual shareholders from evading taxation through failure to list their holdings as personal property. Suppose, for instance, that the state were to change front and require all individuals to list their certificates of stock. What would happen? There would be a multitude of investors who would simply fail to list. It is a matter of common notoriety that taxpayers have no qualms in evading taxes on personal property. It is always extremely difficult to get mortgages, savings and other intangibles on the tax books and even tangible personal property is hard to find; and when found it is seldom given in at anything like its real value in money. When the state, therefore, assesses the stock and collects the tax from the corporation rather than from the individual owners, the door to the evasion of taxes on personal property in the form of corporate securities is closed, the state is able to realize its full revenue, and investors are placed under a more equitable scheme of taxation.

The legislative method of exempting stocks when the tax is paid by the companies provides for the taxation of resident and non-resident stockholders alike. "No state can levy a tax, except through the corporation itself, on shares of stock in the hands of non-residents of the taxing state, for such property is beyond its jurisdiction."[20] Unless the tax on the capital stock is paid by the issuing concern, non-resident holders of the stock escape from its payment entirely. When North Carolina levies a tax on the issued and outstanding capital stock of domestic corporations or on corporate property, the tax is collected regardless of where the holders of such stock may reside. If the shares were not taxed in this manner, the state would lose the revenue secured from the assessments paid by the corporation on the certificates of stock owned by non-residents, since it is only in this way that the certificates may be reached at all.

North Carolina's policy of taxing stocks through the incorporated enterprises themselves makes possible a saving in the costs of tax collection. One of the important considerations concerning every tax law is the administrative cost of collecting the tax. Other things being equal, the more expensive and complicated the machinery for collection, the more undesirable the law. This principle is espe-

[18] Seligman, Edwin R. A., *Essays in Taxation*, Ninth Edition, 1921, p. 298.
[19] 184 N. C. 518.
[20] 184 N. C. 519.

cially applicable to the taxation of corporate stocks. When the corporation rather than the stockholder is assessed on the stock, the government collects the tax at its source and avoids the great expense and difficulty of collecting it in small amounts and from stockholders widely scattered throughout the state.

The taxation of stocks through the corporations issuing them stimulates the permanent investment of capital in the state. Generally capital under modern circumstances seeks investment in the corporate form of organization. If such capital invested in corporations in North Carolina "is to be taxed twice in the same jurisdiction it will flee from the borders of the state and seek investment under fairer and more favorable laws."[21] In other words, just as long as more than forty states competing with North Carolina for capital investment do not tax capital invested in corporate enterprises twice, the State of North Carolina can not afford to tax it twice if it would retain such capital for the continuous development of its industrial enterprises.

Lastly, the law assessing corporate stocks through the company prevents double taxation. When the state levies a tax on the corporation's real and personal property and in addition a tax on the corporate excess, corporate property has been fully taxed once and to tax the certificates of stock in the hands of the shareholders, which have value only as the taxed property of the corporation has value, is equivalent to duplicate taxation. "If the corporation be required to pay a tax on the capital stock as valued under the statute, and the shareholders a similar tax on all their shares, double the amount of money or property contributed by the shareholders is thereby taxed, and no play upon words can escape the logic of this conclusion."[22] To quote Professor Seligman again: "Is it permissible to tax the corporation on its property and again on its capital stock? The answer from the economic standpoint is simple. While the exact relations between capital stock and property are more fully discussed below, it is clear, for the purpose of this argument, that corporate property is at all events one of the elements that contribute to the value of capital stock. If this be true, to tax the corporation on its property and then levy an additional tax on its stock is *pro tanto* duplicate taxation of an unjust character."[23] While the author is discussing the taxation of the corporation on both its property and its capital stock which represents its property, the doctrine applies with equal force to the taxation of the corporation on its property and the stock in the hands of the shareholders.

To go a little further into the matter, is taxing the corporation, whether on property or income, always equivalent to taxing the shareholder?[24] Or may the corporation tax be shifted to the consumers of the corporation's products or fall on the original stockholder and allow the new security purchaser to go tax free? The answer depends upon the system of taxation. Sometimes the tax can be shifted to the consumer, and when this can be done, of course, the shareholder

[21] 184 N. C. 519.
[22] 184 N. C. 508.
[23] Seligman, Edwin R. A., *Essays in Taxation*, Ninth Edition, 1921, pp. 109-110.
[24] For a full discussion of this important question, see Seligman, Edwin R. A., *Essays in Taxation*, Ninth Edition, 1921, pp. 308-11.

escapes entirely. But such is not always possible. There are circumstances under which the tax cannot be shifted to the consumer, and when this occurs the taxation of the corporation is the taxation of the stockholders unless the tax can be shifted in some other direction.

If the income tax is a part of the general scheme of income taxation, falling on corporate and non-corporate enterprises alike, it is impossible to shift the tax. Since the tax affects all investments in the same manner, owners of stock whose return is reduced by the tax can not find non-taxable securities from which they can secure the original rate of return. Consequently, taxing the corporation is taxing the holder of the stock and to tax both would indeed be double taxation. But if the tax is only partial or levied on a few types of enterprises, the tax might be shifted. For example, if the stockholder at the time the tax is imposed attempts to sell his stock, the purchaser will discount the tax in the price he pays and will really buy the stock tax-free. But since the corporate income tax in North Carolina is general and not partial, the tax can not be shifted in this fashion, because all corporate enterprises are subjected to the same tax. Of course there might be some shifting in comparison with individual enterprises and partnerships, since they are taxed on a graduated basis up to $10,000, or some shifting in comparison with tax-exempt government bonds; but otherwise, where the state taxes corporate income, it taxes the shareholders who are entitled to that income.

The same general conclusion applies to the property tax. Since the property tax in North Carolina is levied on all corporations alike, or rather on all kinds of real and personal property alike, it is impossible to discount the corporation tax in the lower market value of the shares of stock. Of course there might be some shifting again in case of tax-exempt government bonds. Likewise, there might be some shifting in case of personal property or investments in the hands of individuals, since such property is very difficult to find and still more difficult to get on the tax books at its real value. But in general, when the local sub-divisions in North Carolina tax the corporation's property, real and personal, including the corporate excess, they tax the shareholder. Thus, North Carolina's present method of taxing shares of stock conforms to sound economic principles and prevents the existence of double taxation in the state's system of taxing corporate enterprises.

Since these are the advantages of taxing stocks through the corporations themselves, what are the alleged disadvantages? Or to put the question in a little different manner, what are the arguments against the state's present system of taxing corporate stocks? The arguments are:[25] (1) that since corporate stocks are liable as personal property for inheritance taxes, they should be liable for annual property taxes; (2) that such stocks are "exempted from paying their fair share, or any share, of the burden of carrying on the government;" (3) that the corporation and the shareholders are separate and distinct legal entities and should be taxed as such; (4) that there is no more reason for exempting stocks levied on

[25] These arguments have been abstracted and summarized by the author of this article from the dissenting opinion of Chief Justice Clark and from the contentions of the plaintiff as set forth in the opinion of the court.

through the company itself than bonds; (5) that existing taxes on corporations do not justify the exemption of stocks; (6) that stocks are idle capital and should be taxed on account of their unproductiveness; and (7) that taxing both the stockholder and the company is not double taxation.

The argument that corporate stocks occupy the same position with regard to annual taxes as with regard to inheritance taxes can be answered without very much difficulty. It is true that the state levies inheritance taxes directly on stocks in the hands of shareholders, or rather when such stocks pass into the hands of inheritors, but that is no reason why it should levy on such stocks for annual or current needs. The inheritance tax is a levy on the privilege of inheritance, falling upon the inheritor and is paid once and for all. It does not concern the corporation in any manner whatsoever. But annual taxes do concern the corporation. They are assessed on the income and the value of the corporate property plus the value of the corporate stock. Since the state collects nothing from incorporated companies in the form of inheritance taxes, it is justified in collecting such taxes from the estates of deceased shareholders. Since it does collect from such companies in the form of annual taxes, it is not justified in collecting again from the shareholders.

In addition to the argument that corporate stocks should be liable to annual as well as inheritance taxes, there is the contention that such stocks escape from their "fair share or any share" of the burden of taxation. Is this contention valid? To answer that question it is necessary to refer again to the existing system of corporate taxation. How can it be argued that stocks escape from any or all taxation when there are four different kinds of taxes on corporations, three of which are annual taxes, taking large amounts of money which would otherwise go to the stockholders? While stockholders are not taxed directly, nevertheless they are taxed indirectly, the state collecting from them at the source through the companies whose stock they own.

As has already been indicated, three of the taxes levied on corporations are state taxes and the other is a local tax. The incorporation tax is assessed at the inception of the company and is paid once and for all. The state treasury collected from this source during the fiscal year from July 1, 1921 to June 30, 1922 the sum of $64,107.50.[26] The franchise tax is an annual tax and is imposed for the privilege of doing business. The state collected from this tax during the fiscal year just mentioned the total of $586,658.74. This amount is exclusive of the $870,583.61 collected from special privilege and license taxes and gross receipts taxes on insurance companies, sleeping car companies, express companies, and telephone and telegraph companies. As to the three per cent corporate income tax, there are no available figures, for the treasurer's report makes no distinction between corporate and non-corporate incomes; but we may safely assume that the amount would be rather large due to the very nature of the tax and to the volume of corporate income in recent times.

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[26] *Report of the Treasurer of North Carolina*. Dec., 1921 to July 1922, p. 13.

But it is alleged that the franchise taxes are insignificant in amount, and that on such grounds stocks taxed through the companies themselves should not be exempted. While this contention standing alone has some merit, it must be remembered that almost $600,000, exclusive of the amount secured from special license taxes and taxes on gross receipts, is worth some consideration and that such taxes are only a part of the scheme of state taxation. When the corporate income tax is added, there is a different story to tell. Since the latter tax is based upon a higher rate than the personal income tax, there is a heavier tax burden upon corporate enterprises than upon individuals and partnerships. As illustrative of this point, suppose A invests $200,000 in a single enterprise or a partnership, and B the same amount in a corporation. Again, suppose each of them receives $20,000 net annual income from their respective investments. Under the income tax law, they are entitled, if married, to a personal exemption of $2,000. Assuming that they both are married, what taxes would they pay into the state treasury? A would pay $415, calculated on $18,000 net income at a rate of from one to three per cent up to $10,000 and three per cent on all over that amount; while B (through his corporation of course) would pay $740, calculated at the rate of three per cent on $18,000 plus one-tenth of one per cent as a franchise tax on the issued and outstanding capital stock of $200,000. Consequently, instead of investors in corporate stocks escaping their share of state taxation, they really carry a heavier tax burden than investors in single enterprises and partnerships.

Furthermore, the owners of corporate shares do not escape their share of local taxation. The fourth tax levied on corporations is the *ad valorem* tax. Since this is strictly a local tax, incorporated concerns and single enterprises and partnerships are treated exactly alike, with the exception of the method of appraising the value of the capital stock. As already explained, the capital stock is valued for the purpose of taxation so as to get at the amount of the corporate excess over the corporation's real and personal property, and on this every company pays an additional tax. In this way every item of corporate property is subjected to county and municipal taxation.

But it is argued that the amount of the corporate excess is very small. Why should it be otherwise? Is not the value of a corporation determined largely by its real and personal property? Out of the total of $3,156,243,202 taxable property in North Carolina in 1920, land including mineral and timber land represented $1,159,224,472; town real estate $541,764,591; personal property $644,986,221; railroads, telegraph, telephone, street railway, and other corporations exercising the right of eminent domain $245,660,780; bank and building and loan stock $24,031,456; corporation excess $49,140,854; and real and personal property of domestic corporations $508,458,435.[27] Out of the total, corporate property represents about $828,000,000, or more than one-fourth; and while the corporate excess is rather small, it may be concluded that North Carolina corporations, along

[27] *Report of State Commissioner of Revenue of North Carolina*, 1921, p. 446. The figures for 1921 and 1922 are not available. While the author of this article tried to secure more recent figures both as to the value of taxable property and the income tax, the Commissioner of Revenue was not ably to supply them.

with individual enterprises and partnerships, pay their full measure of local taxation, provided the administrative officers of North Carolina's tax system are efficient in the performance of their fiscal duties.

There is not only the argument that corporate shares escape from all taxation, but there is also the argument that the corporation and the stockholders are separate legal entities and should be taxed as such. While they may be separate and distinct entities legally, they certainly are not separate and distinct entities economically. A certificate of stock is simply an evidence of the holder's interest in the company's property. Aside from the property it has no value. "The value of all the property owned by a corporation, of whatever kind, including its franchise, is the true and fair measure of the value of all its stock."[28] As Chief Justice Chase once pointed out: "How can a man's shares of any property be the subject of valuation at all, if not with reference to the amount and productiveness of the property of which they are a part? What value can they have except that given by that amount and that productiveness? A certificate of the title to a share is not a share. It is evidence of the shareholder's interest. His interest may be transferred by the transfer of the certificate; but it is not the certificate that is valued when the worth of the share is extimated . . . It is the property which it represents that is valued."[29]

Since stocks have value only as the corporate property has value, how is it possible to justify the taxation of both as separate and distinct things? When both are taxed there is a clear violation of economic principles. There is no other valid conclusion. If the state through its various local subdivisions taxes corporations on about $828,000,000 worth of property and then turns around and requires the stockholders to list their shares and pay a tax thereon, double the amount of actual property is levied on and investors in corporate enterprises carry twice the tax burden that is carried by investors in partnerships and individual enterprises. While without doubt the state has the power to tax both the corporation and the shareholders, since it creates the corporation and determines the scope of its operations and the liabilities of its members, nevertheless such taxation would be directly opposed to the very economic nature of corporate organization.

Then, there is the argument that there is no more reason for exempting stocks assessed through the incorporated concern itself than bonds. This contention is valid. While corporations are allowed to deduct current indebtedness in fixing the tax value of solvent credits, they are not allowed to deduct outstanding bonds. If, for example, a corporation has $100,000 worth of taxable real and personal property and this property is covered by a capitalization of $50,000 in stock and $50,000 in bonds, it is taxed on $100,000, not on $50,000. In other words, the company is assessed on its property or assets purchased through the issuance of bonds as well as through the issuance of stock. When bondholders are required

[28] 184 N. C. 515.

[29] Dissenting, in *Van Allen* v. *Assessors* (1866) 70 U. S. (3 Wall) 598, 18 L. Ed. 229. Cited in Chief Justice Clark's dissenting opinion.

to list their bonds as personal property and pay a tax thereon, the same capital is taxed twice. Since this is the case under the law of North Carolina, there is double taxation just the same as there would be if stocks were taxed in the hands of the shareholders. To be consistent and conform to sound economic principles, we should exempt both bonds and stocks in the hands of investors from taxation.[30]

Just as it is argued that there is no more basis for exempting bonds than stock, so also it is argued that existing taxes on corporations do not justify the exemption of stocks. Chief Justice Clark says: "They [corporations] pay, and should pay, on their property, but in doing so there is no reason why those to whom they sell their stocks, and whose money they receive in exchange, should be exempt from taxation on the stocks and bonds of these corporations."[31] Is this a sound conclusion? It would hardly seem so if the concept of justice is to find lodgment in the scheme of taxation. The cardinal doctrine back of every tax system is equity. Unless tax laws are equitable, they are indefensible. In attempting to uphold the assessment of corporate stocks as personal property, existing taxes on the corporation which ultimately rest on those stocks can not be entirely ignored. Since, as has already been shown, investors in corporate enterprises really bear a heavier tax burden than investors in individual enterprises and partnerships, corporate shares already pay their full measure of taxation through the companies themselves, and to contend that existing taxation does not justify the exemption of stocks is equivalent to denying the need for justice in the state's system of raising revenue.

Furthermore, it is alleged that corporate stocks are "idle capital, whose owners do nothing for the public welfare, but simply live on that which comes to them without effort as coupon clippers or dividend drawers."[32] While it may be true that the owners of stocks as individuals in many cases are unproductive and make little or no contribution to the public welfare, it is certainly not true that the shares themselves, or rather the capital which they represent, are unproductive. The corporation is the most efficient type of business organization that has arisen in modern times. It enables business enterprisers to get together large amounts of capital from a variety of sources through the issuance of transferable shares. These transferable shares are the evidence of property interest and indicate what each stockholder has contributed. While they in and of themselves produce nothing, the economic goods for which they stand are productive, and to affirm that they represent idle capital and should be taxed for their alleged idleness is to misunderstand entirely the economic significance of corporate organization.

Finally, there is the contention that the taxation of both the stockholder and the company is not double taxation. As proof of this point, reference is made to a multitude of court decisions. While it is true that numerous court decisions have held either that double taxation is not necessarily unconstitutional, or that

[30] For a comprehensive treatment of this point, see chapters 6, 7, 8, Seligman, Edwin R. A., *Essays in Taxation*, Ninth Edition, 1921. On page 315, he says: "Where the corporate stock or property is taxed, the shareholder should be exempt. If corporate loans are taxed, the bondholder should be exempt."

[31] 184 N. C. 522.

[32] 184 N. C. 526.

there is no double taxation, because of the distinct legal entities involved, in taxing both the corporation and the individual shareholder, yet these decisions can not alter the inevitable economic fact that such taxation actually does result in taxing the same assets twice. It is simply impossible to reach any other conclusion so long as corporate property is what it is. While it is admitted by all that the Constitution of North Carolina "neither forbids nor requires" double taxation, the legislature has refrained from levying a double tax on both the corporation and the stockholders, and in doing so has perhaps demonstrated its familiarity with the principles of public finance as well as with the principles of economics.

The decision upholding the present method of taxing stocks in North Carolina corporations, then, is sound. By exempting corporate shares, investors in corporate enterprises do not escape all taxation, since the enterprises themselves are adequately taxed and what they pay ultimately comes out of the pockets of the individual owners of the stock. The advantages of the existing system are: that it prevents double taxation, stimulates the investment of capital in the state, makes possible a saving in tax collection, provides for the taxation of resident and non-resident stockholders alike, restrains stockholders from dodging taxation through failure to list their shares, harmonizes with the systems in other states, and conforms to the state's permanent policy in taxing corporate property. The only inconsistency is that bonds in the hands of individual bondholders are not exempted, since the corporation is taxed on the property or assets represented by bonds as well as by stocks. In general, North Carolina's policy of taxing corporate shares is a sane policy, and, unless there are radical changes in corporate organization, it should be continued by the legislative assemblies of the future.

In this connection, it is interesting to note that the doctrine of the principal case has recently been adhered to as a basis for the taxation of cotton held by coöperative marketing associations.[33] Instead of requiring the farmer to list his cotton, the tax authorities and the Attorney General have announced that the cotton must be listed by the coöperative association. The grower's certificate of sale is treated in many respects like a share of stock, and it is held that to tax both the farmer on his certificate and the association on its cotton in storage would be double taxation. The economic consequences of this change in the method of listing cotton for taxation will deserve study.

[33] See the *Greensboro Daily News* for Tuesday, May 8, 1923, page 1, column 4.