BANKS & BANKING: (1) Taxation of Banks and Trust Companies;
(2) Preferred Stock;
TAXATION: (3) Capital Notes;
(4) Stock owned by Reconstruction Finance Corporation not taxable.

February 19, 1935

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Wilcox

State Tax Commission
of Missouri
Jefferson City, Missouri

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Gentlemen:

This is to acknowledge your letter as follows:

"The assessment of bank stock as provided for in Section 9765 as amended at the '31 Session at page 357, Session Acts, authorizes the assessment of bank stock, and provides among other things that the chief officer of the bank shall deliver to the assessor 'a list of all shares of stock held therein, and the face value thereof, the value of all real estate, if any, represented by such shares of stock, together with all reserved funds, undivided profits, premiums or earnings and all other values belonging to such corporation, company, institution or association; and such shares, reserved funds, undivided profits, premiums or earnings and all other values so listed to the assessor shall be valued and assessed as other property at their true value in money."

The last two or three years a new development in the capital structure of banks and trust companies has been the issuance of preferred stock and issuance of capital notes divided into two classes, A notes and B notes.

> "The question now arises as to whether or not preferred stock and capital notes are to be considered as capital stock of the banking or trust company for the purpose of assessment.
>
> We would like your opinion as to whether or not preferred stock and capital notes are to be treated as capital stock in making assessment for Ad Valorem tax.
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> In some cases these notes are owned by the Reconstruction Finance Commission, a Federal department.
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> After a study of these new methods of finance by banks and trust companies, we are inclined to believe that capital notes, when held by a department of the Federal Government, may be excluded from the capital structure of the bank, but if held by an individual they are assessable at their par value for Ad Valorem tax. The assessment to be against the owner and the tax to be paid by the bank, the same as other bank stock, and that all surplus values above preferred stock be attached to the common stock of the bank."

Before proceeding to answer the questions contained in your letter we shall first summarize the method of taxing banks and trust companies.

I.

TAXATION OF BANKS AND TRUST COMPANIES.

Laws of Missouri, 1931, page 357, Section 9765, relating to assessments of banks and trust companies, provides in the part material as follows:

> "Persons owning shares of stock in banks, or in joint stock institutions or

> "associations doing a banking business, shall not be required to deliver to the assessor a list thereof, but the president or other chief officer of such corporation, institution or association shall, under oath, deliver to the assessor a list of all shares of stock held therein, and the face value thereof, the value of all real estate, if any, represented by such shares of stock, together with all reserved funds, undivided profits, premiums or earnings and all other values belonging to such corporation, company, institution or association; and such shares, reserved funds, undivided profits, premiums or earnings and all other values so listed to the assessor shall be valued and assessed as other property at their true value in money, less the value of real estate, if any, represented by such shares of stock, less, also, the value of stock in other corporations held by such bank or joint stock institution or association doing a banking business: Provided, however, that no deduction shall be allowed on account of stock in any one manufacturing or business company in excess of forty per cent. of the capital, surplus and undivided profits of such bank or joint stock institution or association doing a banking business. Private bankers, brokers, money brokers and exchange dealers shall make like returns and be assessed and taxed thereon in like manner as hereinbefore provided:"

Assessment of taxes on the capital stock of a banking corporation is made against the shareholder and not the bank. The assessment on shares of stock issued by a bank is assessed against the owners. However, the bank pays the tax as fixed by the assessor and recovers same against the shareholders. In other words, the bank is more or less an agent for the shareholders.

In State ex rel. v. Cantley, 26 S. W. (2d) 976, the Supreme Court of Missouri, en Banc, (l. c. 979) said the following:

> "Whether or not, as between the bank and its shareholders, the bank is their mere agent for the payment of their taxes, the statute in plain terms makes the bank directly responsible for the payment of the taxes assessed against the shareholders. The duty of the bank to pay the tax, if it has assets with which to pay it, is a personal liability of the bank to the tax collector. State ex rel. Bay v. Citizens' State Bank, supra, 274 Mo. pages 68 to 71, 202 S. W. 382."

In State ex rel. United States Bank et al. v. Gehner, 5 S. W. (2d) 40, l. c. 43-44, the Supreme Court of Missouri said:

> "In State ex rel. Miller v. Shryack, supra, Marshall, J., speaking for this division of this court, in discussing the purpose and intent of our state statute aforesaid, said (179 Mo. loc. cit. 440 (78 S. W. 812)):
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> 'The conclusion is inevitable that the true meaning of the act of 1895 (now section 12775, R. S. Mo. 1919) is, that the real estate shall be assessed against the (bank) corporation, the personal property of the corporation shall not be assessed at all, and the shares of stock shall be assessed in the names of the shareholders. Thus the domestic (bank) corporations and the national banks are put on the same basis, there is no discrimination and the letter and form and substance of the power conferred by the federal

> "statute are observed. The bank in question is a domestic bank, but the law is the same as to it that it is as to national banks. After the assessment is thus made against the shares of stock in the names of the shareholders, it is legal to make the bank pay the tax and recover it from the stockholders. Section 9155, R. S. 1899; First National Bank v. Commonwealth, 9 Wall, 353 (19 L. Ed. 701); Aberdeen Bank (First Nat. Bank) v. Chehalis Co., 166 U. S. 440, 17 S. Ct. 629, 41 L. Ed. 1069).' (Parentheses ours.)"

In State ex rel. v. Buder, 242 S. W. 979, the Supreme Court of Missouri, en Banc, page 980 et seq., said:

> "The shares of stock represent the value of all the assets of the corporation. 14 C. J. 385.
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> * * * * * * * *
>
> It is apparent that the purpose of the enactment of section 12775, R. S. 1919 (Section 9765) was to provide a scheme for taxing state and national banks to conform to section 5219, R. S. U. S. (U. S. Comp. St. Sec. 9784) * * * * * How is the value of the stock which represents all the corporate assets to be ascertained? The real and personal property constitute its assets; all represented by shares of stock. It is too clear for argument that from the total value of the assets there must be deducted the corporate liabilities because these affect the value of the stock. Unless this deduction is made, the value of the stock will be, to that extent, inflated and fictitious."

And further,

> "This is precisely what the trust company did. It deducted its liabilities from the gross value of its assets. That determined the value of its stock."

The value of the shares are computed according to Section 9765, supra, namely:

> "deliver to the assessor a list thereof, but the president or other chief officer of such corporation, institution or association shall, under oath, deliver to the assessor a list of all shares of stock held therein, and the face value thereof, the value of all real estate, if any, represented by such shares of stock, together with all reserved funds, undivided profits, premiums or earnings and all other values belonging to such corporation, * * * ; and such shares, reserved funds, undivided profits, premiums or earnings and all other values so listed to the assessor shall be valued and assessed as other property at their true value in money, * * *."

Above we have shown that the shares of stock represent the value of all the net assets of the corporation assessable to bank and/or shareholder. Thus, in determining the value of shares of stock certain liabilities should be deducted therefrom, to-wit: deposits; accrued interest and taxes; in fact, all liabilities otherwise assessed.

In State ex rel. v. Buder, supra, the court said:

> "This indebtedness of $1,725,000, being a liability of the trust company, it thus appears that the sole question for

> "consideration is whether in determining the value of the stock this liability should be deducted from the amount of the capital, surplus, and undivided profits of the company, as stated by respondents."

And further,

> "The objection to the deduction of this particular liability is that it is secured by a mortgage on the real estate of the trust company and is not an investment of its funds. It is still a corporate liability which affects the value of the shares of stock."

And further,

> "It is too clear for argument that from the total value of the assets there must be deducted the corporate liabilities because these affect the value of the stock. Unless this deduction is made, the value of the stock will be, to that extent, inflated and fictitious."

And further,

> "It follows that the action of the board of equalization on March 30, 1922, increasing the assessment against the shares of stock of the Liberty Central Trust Company, from $1,730,570 to $3,415,570, for the taxes for the year 1922, was illegal, and the record of the board making said increase is quashed."

Above it is seen that certain liabilities are deductible in arriving at the net assets of the corporation. However, all liabilities are not deductible, for example, "Capital Stock", because of Section 9765, supra, which provides in part:

> "deliver to the assessor the list of all shares of stock held therein, and the face value thereof."

Your letter uses the words "preferred stock and capital notes." We herewith call your attention to the fact that such are separate and distinct.

II.

PREFERRED STOCK

Laws of Missouri, 1933, pages 406-408, provides that a bank, trust company or other financial institution may issue and sell preferred stock (Section 1). Preferred stock is a liability but not a deductible liability (except when owned by a Federal agency -- hereinafter discussed).

Section 4, Laws of Missouri, 1933, page 407, provides:

> "No shares of preferred stock having a par value of less than Twenty Dollars ($20.00) nor more than One Hundred Dollars ($100.00) shall be issued by any corporation to which this act applies; and, no such shares shall be sold under authority of this act for less than one hundred cents on the dollar of the par value thereof net to the issuing corporation; and, no such shares shall be valid until one hundred per cent (100%) of the par value thereof in lawful money of the United States has been paid into the treasury of the issuing corporation."

In our opinion, preferred stock is part of the capital stock and is not a deductible liability and should be assessed at its par value (exception -- when owned by a Government agency) because of its preferences and priorities and the return on same being fixed. Section 5, Laws of Missouri, 1933, pages 407-408.

III.

CAPITAL NOTES

Laws of Missouri, Extra Session, 1933-34, pages 144-147, provides that capital notes may be issued and sold by banks and trust companies (Section 5312).

Section 5312, in part provides as follows:

> "Such capital notes may be sold for cash or, with the written consent and approval of the commissioner of finance, for property and they shall be of a nature specified in, and conform to, the requirements of the several provisions of Sections 5312 to 5315 inclusive."

Section 5313, Paragraph "A", provides:

> "Such capital notes shall be in such denominations and the holders thereof shall be entitled to such annual return thereon not exceeding 6% as the Board of Directors of such bank or trust company may determine. Such capital notes shall provide that they may be retired at such time or times and in such manner as may be fixed by the board of directors of the bank or trust company, but in no event later than twenty years after the date of their authorization; provided, however, that no bank or trust company shall retire such capital notes if by such retirement an impairment of its capital will be created."

Paragraph "C" provides:

> "If an impairment of capital exists in whole or in part by reason of the fact,

> "as determined by the commissioner of finance, that certain assets of such bank or trust company have depreciated in value, in that event said bank or trust company may issue to the holders of said capital notes a right of participation to such extent as may be agreed upon in any increase in the value of such assets."

Having ruled above that preferred stock is a part of the capital stock it now devolves upon us to determine whether or not capital notes are part of the capital stock as far as assessment purposes are concerned. It must be borne in mind that the 1933 Legislature authorized banks and trust companies to issue preferred stock for the purpose of increasing their capital structure. The 1933-34 Legislature in Extra Session, no doubt, were apprised that the issuance of preferred stock did not (or would not) fully bring enough capital into the banks. Consequently, provision was made for the issuance of capital notes. The only purpose that capital notes serve is to furnish new capital to the banks. The issuing of capital notes in reality is the same as selling capital stock without giving the purchaser a voice in the affairs of the bank. Holders of capital notes are nothing more than limited stockholders. A holder of capital notes cannot sue the bank in event of defalcation; and receives no profit unless the bank makes it; there is no liability on the bank if it does not earn the six per cent. provided by Section 5313, supra. In the event of dissolution the status of the holders of capital notes are not that of common creditors. In other words, the issuance of capital notes was a scheme to increase the capital structure of a bank without increasing its capital stock.

In our opinion, holders of capital notes are in the same class as stockholders (as far as assessment purposes are concerned), and the capital notes are not deductible from the assets of the corporation. If capital notes were deducted from the assets, then such would have to be assessed to the individual owners. To hold that such are deductible liabilities would, in our opinion, upset the whole arrangement now provided for the assessment of bank stock in this State. The capital notes are not deductible liabilities for assessment purposes.

IV.

PREFERRED STOCK AND CAPITAL NOTES OWNED
BY RECONSTRUCTION FINANCE CORPORATION

The Reconstruction Finance Corporation was organized January 22, 1932, by Act of Congress, Title 15, Section 81 to end, U. S. C. A., page 69, 1934 Cumulative Annual Pocket Part.

Section 602 provides that the capital stock is owned by the United States.

Section 610 of the Reconstruction Finance Corporation Act, page 86, provides in part as follows:

> "The corporation, including its franchise, its capital, reserves, and surplus, and its income shall be exempt from all taxation now or hereafter imposed by the United States, or by any Territory, dependency, or possession thereof, or by any State county, municipality, or local taxing authority; except that any real property of the corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. (Jan. 22, 1932, c. 8, Sec. 10, 47 Stat. 9.)"

An instrumentality or agency of the United States being wholly owned by the United States is not subject to taxation without the consent or express legislation by Congress.

In United States v. Coghlan, 261 F. 425, the United States District Court of Maryland (page 426) said:

> "It was shown that all the stock of the Fleet Corporation was owned by the government, and that all it did was done for government account, and that all the

> "profits which it made would inure to the government, which would have to stand all the losses. Under such state of facts, it is unnecessary to inquire whether for all purposes the Fleet Corporation is the government. It suffices that it is a governmental agency, exclusively employed in governmental work, and as such its property is not liable to state taxation."

See also,

Clallam Co. v. United States, 263 U. S. 342, 18 L. Ed. 328.

Above we have shown that the assessment of taxes against bank stock is made against the owners of the shares and in the name of the owners but that the bank pays the tax as agent for the owner of the shares. If the Reconstruction Finance Corporation owns shares of stock (being not taxable) such should be deducted as a deductible liability of the bank. In our opinion preferred stock and capital notes owned by the Reconstruction Finance Corporation should be deducted from the capital structure of the bank for assessment purposes.

Yours very truly,

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APPROVED:

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