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VALUATION OF PUBLIC UTILITIES FOR AD VALOREM TAXATION

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THE general property tax, upon which our state and local governments still rely most heavily to fill their treasuries, has long been a focus of criticism. One of our ablest commentators, having with admirable comprehensiveness summed up the experience of both European and domestic tax authorities, has said that as a result of "inherent defects" "the general property tax in the United States is a dismal failure;" "the whole system is unsound;"¹ "practically, the . . . tax as actually administered is . . . one of the worst taxes known in the civilized world."² These are general judgments that express attitudes resulting from innumerable particular instances and experiences. The critically minded usually ask for a bill of particulars. To one who would contrive such a bill, a number of paths are open; but few offer the convenience and accessibility and wealth of the law digests. Necessity and interest alike dictate a limitation of the bill to only a portion of that "wilderness of single instance," and the chosen portion has to do with public utilities and the valuation process that usually, though not invariably, is part of the property tax machinery.

So long as states require tax contributions to be measured by the value of citizens' property, problems of valuation seem destined to abide. When property is simple and bears no functional relationship to other property, the assessors' estimates of value are considered sufficient. But obviously, where the property is tremendously complex, as with public utilities, and the considerations involved are legion, simple judgments will not do. More complicated methods must be resorted to. Out of this necessity grow the many problems of valuation that seem to be inevitable adjuncts of the *ad valorem* system. The following pages are

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¹ SELIGMAN, *ESSAYS IN TAXATION*, (9th ed. 1921) 31.

² SELIGMAN, *op. cit. supra* note 1, at 62.

devoted to a review of some of them, and to the proposal of a possible solution.

In the domain of corporation and public utility taxation, the great bother began with the dawn of the perception that the articulation of properties into operating units gave rise to intangible values. These values had theretofore escaped taxation under methods designed only for comparatively simple and isolated physical properties. Steps calculated to capture these values were seasonably taken. The unitary grouping and functioning of physical properties that brought forth intangible values demanded that they be assessed as units. Out of this necessity was born the unit rule, by which the properties of corporations extending over several taxing jurisdictions may be assessed as a unit in order to reach "the value resulting from the combination of the means" by which business is carried on. That physical properties when combined into a functioning organic whole in the form, for example, of a going public utility possess a value far beyond the sum of the values of the individual parts is, of course, fundamental;³ and the unit rule, achieved not without some struggle,⁴ is and has long been a basic dogma of taxation.

The gains from reaching intangible values were not to be had without further cost, however; for unitary assessment carries its peculiar retinue of problems. There is the great question of what constitutes a unit. What kind of relationship of properties shall be said to render them a unit? What kind of properties should be included? There are many kinds of property, and subtle shadings of relationship. Secondly, how shall these properties be valued, sprawling as they often do wide over countryside, far beyond the taxing jurisdiction, and including,

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³ Courts sustain assessments attacked because they include some or all intangible values, *State v. Western Union Tel. Co.*, 111 Minn. 21, 124 N. W. 380 (1910); *In re Oklahoma Gas & Electric Co.*, 67 Okla. 301, 171 Pac. 26 (1918); *State v. Pullman Co.*, 178 Wis. 240, 189 N. W. 543 (1922); hold assessments that omit intangible values to be erroneous, *Atchison, T. & S. F. Ry. v. Sullivan*, 173 Fed. 456 (C. C. A. 8th, 1909); *In re Assessment of Western Union Tel. Co.*, 35 Okla. 626, 130 Pac. 565 (1912); and grant the remedy of mandamus to compel assessors to include such values, *State v. Savage*, 65 Neb. 714, 91 N. W. 716 (1902); *State v. State Board of Equalization*, 56 Mont. 413, 186 Pac. 697 (1919).

⁴ A hasty perusal reveals how hotly contested was the case of *Adams Express Co. v. Ohio State Auditor*, 165 U. S. 194, 17 Sup. Ct. 305 (1897), opinion on reargument, 166 U. S. 185, 17 Sup. Ct. 604 (1897), decided many years after the unit rule had become a fixed element of tax administration and had been approved by the Supreme Court itself in the *State Railroad Tax Cases*, 92 U. S. 575 (1875). That it should ever have been decided that a railroad should be valued as so many rails, so many ties, etc., as in *Huntington v. Central Pac. R. R.*, Fed. Cas. No. 6,911, (C. D. Cal. 1874) today seems quite absurd.

as they sometimes do, securities tucked away in vaults at the opposite end of the country. Thirdly, since it is elementary that a state cannot tax property outside its jurisdiction, how is the value of the unit, once discovered, to be apportioned so that the taxing jurisdiction reaches only values that can be said to be within it? This has often proved to be not at all easy in measuring and allocating something so imponderable and elusive as intangible values. Lastly, equality being a prime desideratum in taxation, assessments must be equalized,—that is to say, listed at the same proportion of their ascertained value as other property in the same tax class in the taxing jurisdiction. The first and third of these have been fully treated elsewhere in a detailed consideration of the unit rule.⁵ The last, except as it raises peculiarly local problems, ordinarily becomes an issue only when assessing authorities neglect to do it. It is the second that is of concern here.

I

What is this “value” that is the object of assessors’ search under the *ad valorem* system? Is it something single, definite and identifiable? Or is it another phantom, which, like others not unknown in the law, stalks through our reports never to be captured? The initiated in economic doctrine are familiar with the mazes of theory that have grown up about the term. Valuations for rate-making are notorious among lawyers and laymen alike.

It seems that there are values and values, even for the same property, varying, at least in quantitative expression, according to the purpose for which we seek to measure value.⁶ It has been pointed out that in law there are at least a dozen purposes for which that concept is invoked,⁷ and there are doubtless more. Does “value” have a different meaning for each purpose? That thought has been greeted by many judges only with impatience and contempt.

The state legislatures, which have commanded assessors and courts to find value, have also essayed a measure of definition. The commands, varying in phraseology, are to find “true cash value,” “true value in money,” “full cash value,” “fair cash value.”⁸ Then, by way of definition of these terms, the various

⁵ See Isaacs, *The Unit Rule* (1926) 35 YALE L. J. 838.

⁶ See Professor Bonbright’s introduction to DODD, *STOCK WATERING* (1930), describing an undertaking by a group of the faculty of Columbia University to show the various meanings of “value” as used for different purposes.

⁷ Bonbright, *The Problem of Judicial Valuation* (1927) 27 COL. L. REV. 493.

⁸ See Tunnell, *Value for Taxation and Value for Rate Making*, NAT. TAX ASS’N PROCEEDINGS (1927) 263, 264.

statutes declare that value means ". . . the value at which the property would be taken in payment of a just debt due from a solvent debtor;"⁹ "the price it would bring at a fair voluntary sale;"¹⁰ and "its value in the market in the ordinary course of trade."¹¹ These are representative definitions. They come, in short, to market value.

It would have been surprising if legislatures had chosen any other definition, for traditionally in economics and commerce value had long since come to signify "power in exchange" or exchange value; and there was and still is more nearly a consensus in this than in any other use of the term value. In this consensus lies a danger, for it has led many to believe, first, that there is no other proper meaning, and secondly that there is a market value. In fact, some have been led into even greater error, for evidence is not wanting that some judges think of value as *inherent* in things, regarding them metaphysically as a definite attribute of them, like their color. One court, in defining what the local statute meant by the phrase "cash value" said: "This means what has a recognizable pecuniary value inherent in itself and not enhanced or diminished according to the person who owns or uses it."¹² Similar notions of value in the minds of other judges may be inferred from the manner and frequency with which they use the terms "actual value" or "true value"—terms that are liberally scattered through the reports.

Cases reveal little if any uniformity of practice in application of the market value concept. Judicial analysis has rarely gone far enough to disclose the possibility of dozens of variations in markets depending on the time, the place,¹³ the uses to which the property could be put,¹⁴ the bidders, and many other factors. As one commentator has shown, difference of views as to the identity of the bidders alone accounts for three variations in the market value concept.¹⁵ Thus, as one court sees the matter, the present owner may not be considered a bidder, though the prop-

⁹ IDAHO COMP. STAT. (1919) § 3104.

¹⁰ OKLA. CONST., art. 10, § 8; KY. STAT. (Carroll, 1930) §§ 4020, 4078(2); KY. CONST., § 172; cf. ILL. REV. STAT. (Smith-Hurd, 1931) c. 120, §§ 3, 4.

¹¹ NEB. COMP. STAT. (1929) §§ 77-201.

¹² Perry v. City of Big Rapids, 67 Mich. 146, 34 N. W. 530 (1887); cf. dissenting opinion of Mr. Justice White in Adams Express Co. v. Ohio State Auditor, *supra* note 4.

¹³ A mile or two often makes a vast difference. See Cumberland Coal Co. v. Board of Revision, 52 Sup. Ct. 48 (U. S. 1931) (distance of coal lands from a river).

¹⁴ See State ex. rel. Oshkosh Country Club v. Petrick, 172 Wis. 82, 178 N. W. 251 (1920) (golf course held assessable as meadow land since it could be sold only for that purpose). See Rifkind, *What is Fair Value in Taxation?* NAT. TAX ASS'N PROCEEDINGS (1926) 305.

¹⁵ Rifkind, *op. cit. supra* note 14.

erty is worth a great deal more to him than to anyone else.¹⁶ A second court seems to feel that although the present owner may be considered among the bidders, the conception of the market must not go "beyond the point where there would have been competition among probable buyers into the region of value to the petitioner alone."¹⁷ A third court conceives the buyers to be "hypothetical buyers, not actual or existing purchasers," (and the sale, of course, is a hypothetical sale.)¹⁸

Again, the general state of the market may make some difference. Some courts have laid down the rule that values are to be fixed for assessment purposes according to values prevailing at the time the assessments are made,¹⁹ thus ruling adversely to counsel who pleaded that prices prevailing in inflated markets ought not to govern. A demoralized and frozen market owing to depression alters matters profoundly. Governmental expenditures do not vary directly with the cycles of depression and prosperity; and the trend seems always upward. "Was it the purpose of the statute," asks one court, "to jeopardize the machinery of state, county, district, and municipality, during a depression. . .?" ". . . does the law require the rule to be strictly applied to any particular year in which property, due to depression and unhealthy business conditions, has no prospective buyer at any figure?" The answer, of course, was no; consideration of market values is not to be confined strictly to those obtaining in the year of assessment.²⁰

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¹⁶ See *State ex rel. Northwestern Mutual Life Insurance Co. v. Weiher*, 177 Wis. 445, 188 N. W. 598 (1922).

¹⁷ *Massachusetts General Hospital v. Belmont*, 233 Mass. 190, 209, 124 N. E. 21, 28 (1919).

¹⁸ *Pennsylvania R. R. v. Jersey City*, 98 N. J. L. 283, 125 Atl. 921 (1922). In *Turnley v. City of Elizabeth*, 76 N. J. L. 42, 44, 68 Atl. 1094, 1095 (1908), the court said: "The criterion established by statute is a hypothetical sale; hence the buyers therein referred to are hypothetical buyers, not actual or existing purchasers." A very interesting contrast to these cases is presented by the opinion of Mr. Justice Holmes in *International Harvester Co. v. Kentucky*, 234 U. S. 216, 34 Sup. Ct. 853 (1914), wherein a state anti-trust law was declared unconstitutional because the criterion of unlawfulness was a standard of conduct impossible to know in advance and to comply with. The criterion was whether the combination enhanced prices beyond the "true value" of the commodity, that is, what the fair market value of the commodities sold by the persons or firms charged with violation would be under other than existing conditions. The language of the opinion is beautifully pat to the assessment process.

¹⁹ *People ex rel. New York Dock Co. v. Cantor*, 208 App. Div. 52, 203 N. Y. Supp. 424 (2d Dep't 1924); *Mackay Telegraph Co. v. Board of State Affairs*, 149 La. 398, 89 So. 249 (1921).

²⁰ *Central Realty Co. v. Board of Equalization and Review*, 158 S. E. 537, 538 (W. Va. 1931). The statute was ". . . enacted to cover ordinary conditions existing over a period of years."

Compared with the number of kinds of goods offered for sale, there are relatively few highly organized markets, like our security and commodity markets, in which rather definite (though fluctuating) market values are to be found. Certainly there is no such market for public utilities. In whatever degree the ordinary run of goods, articles, and objects may be said to have markets and market values they differ from public utilities. To talk of market values in connection with such corporations is either to thrust the market value concept into a domain where it is quite irrelevant and does not belong or to endow it with an entirely new and peculiar sense.²¹

Since absence of market value is not synonymous with non-saleability, assessors and courts, having been directed to find market value where there is none, have to some extent taken what seemed to be the next best course, that of putting themselves in the position of a prospective purchaser, or, more realistically stated, that of taking into account the multifarious factors that might be supposed to influence a prospective buyer of the particular property. But this is an attempt at a sort of clairvoyance, since the sale and buyers are all "hypothetical," and the results, in the nature of things, unverifiable.

It is perhaps possible that Mr. Justice Brewer was right in asserting that "it is a cardinal rule which should never be forgotten that whatever property is worth for the purposes of income and sale it is also worth for purposes of taxation,"²²—if what it is worth for purposes of sale could be found. But why, after all, should market value be the goal of a tax assessment? Sale, though perhaps the commonest of purposes for which property is valued, very probably involves many considerations quite different from those relevant to a tax assessment. Although three distinct and well known theories of the proper distribution of the tax burden have been developed and applied,²³ the value at which a taxpayer's property could be sold bears but little relationship to any of them. It may be supposed, as a matter of historical speculation, that since it had for generations

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²¹ "Value" (meaning value in exchange) as the classical economists used the term, becomes almost meaningless in the case of large industrial plants. The plant cannot be exchanged; it can only acquire new managers; and its only 'solid value' (to coin a phrase) is the possibility of its being useful to commercial society." A. A. Berle, Jr., Book Review, (1931) 31 COL. L. REV. 1225, 1227.

²² *Adams Express Co. v. Ohio State Auditor*, 166 U. S. 185, 220, 17 Sup. Ct. 604, 606 (1897).

²³ See Rottschaefer, *A State Income Tax and the Minnesota Constitution* (1928) 12 MINN. L. REV. 683, at 694, 696. The three are: the benefit theory, the ability-to-pay theory, and the theory that "taxes should be so distributed as to promote desirable social policy, and in the light of the probable social consequences of different methods of their distribution."

been customary to measure a man's portion of the tax burden by his riches, when legislatures came to define the "value" that was to be sought they gave the only definition upon which a consensus had been reached, and that was market value. Custom, however well it may serve as an explanation, is a pretty lame reason for continuing an unsatisfactory practice. Would it not be better to accept the judgment of experienced observers, one of whom has said: "Let us be honest and face the fact that no man on God's earth can find out the value of ninety *per cent* of taxable property. We shall have to recognize that in many if not in all cases value is an impossible tax basis. This was recognized long ago in Europe. . ." ²⁴ If the above view holds good for "many if not all cases" how much more forceful must be its application to public utilities!

Assessment, however, must go on. The ship of state requires fuel. Assessors and courts are engaged in doing something with *ad valorem* taxes. What is it? The answer is that assessors and courts and a few legislatures have contrived certain formulae and procedures for arriving at a sum that becomes the tax base. Since the command is to find "value," that, by the grace of legislatures and courts, is the result. But it is value for taxation purposes. In tax cases "value" means no more than the culmination of a process commanded by legislatures, refined and regulated by the courts. The process is named valuation. The steps in it are not alike in the different states, although there are certain elements common to most states, certain ways of going about it, certain data to be taken into account. These methods and usages have grown up in the course of a long history of tax valuations and have become more or less stereotyped. If the end-product of the assessors' labors is contested in the courts, as it frequently is, the definition of value, for those cases, must be extended to include the presumptions and rules and procedure that govern the courts of law.

²⁴ F. R. Fairchild, NAT. TAX ASS'N PROCEEDINGS (1927) 277. The familiar concept of value, though defined by statutes, has left the assessors to whom its definitions are directed in great confusion. See Rifkind, *op. cit. supra* note 14; Tunnell *op. cit. supra* note 8.

Dr. T. W. Page, speaking before the National Tax Association, said: "... value is no proper basis for taxation. . . . As long as we have the property tax, it is just as well to have the law read very much as it does now. It matters very little how the definition of value is phrased. It may be called market value, or fair market value in money, or the law may add any number of descriptive terms.

"In any event, the practice in taxation will continue to be something very different from what the law seems to mean." NAT. TAX ASS'N PROCEEDINGS (1927) 293.

II

Modes of assessment, calculated to reach intangible values, vary from state to state. The favored technique, so far as official endorsement is concerned, is one that for want of a better name might be called the "eclectic" technique. Many courts, instead of laying down some particular and fixed method of valuation, have declared that all relevant data should be "considered" and that the results of no single method should be deemed conclusive.²⁵ The various methods in use are capitalization of net earnings, market value of securities, cost of reproduction new, original cost; other data considered relevant are gross earnings, book value, value as determined by regulatory bodies, and price for which the business has actually been sold. Tax cases have brought forth but little complaint against such a method of dealing with the data, if it may be called a method; in rate valuation cases there is a growing ferment of rebellion against it. "It cannot be," says one court, "that the repetition of a mere legalistic formula before the declaration of the trial court's final determination is sufficient to bless and sanctify the result, no matter what it may be."²⁶ The same sentiment has found equally strong expression in other quarters.²⁷ The basis of objection of rate-making cases would seem equally to exist in tax cases. The virtual absence of protest in tax cases may perhaps be explained, though not excused, on the ground that the financial stake has not been as great and hence the cases have not been as hotly contested. In nearly all cases, the process of "considering" the data remains cryptic and unrevealed. Occasionally, it appears, an average of the results of various methods has been struck and the resulting sum used.²⁸ Broadly speaking, it seems to be

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²⁵ *Baker v. Druesedow*, 263 U. S. 137, 44 Sup. Ct. 40 (1923); *Chicago & N. W. Ry. v. Eveland*, 285 Fed. 425 (D. S. D. S. D. 1922), decree reversed on other grounds, 289 Fed. 783 (C. C. A. 8th, 1923); *Harris Trust & Savings Bank v. Earl*, 26 F. (2d) 617 (C. C. A. 8th, 1928); *Baltimore & Ohio S. W. R. R. v. Commonwealth*, 177 Ky. 566, 198 S. W. 35 (1917); *Chicago, R. I. & Pac. Ry. v. State*, 111 Neb. 362, 197 N. W. 114 (1923); *State v. Savage*, *supra* note 3.

²⁶ *Rosenberry, J.*, in *Waukesha Gas & Electric Co. v. Commission*, 181 Wis. 281, 294, 194 N. W. 846, 851 (1923).

²⁷ See *Matthews, The Effect of the Recent Decisions of the Supreme Court on Reproduction Cost as a Test of Value*, (1924) 37 HARV. L. REV. 431, 460-462, quoting from *Consolidated Gas Co. v. Newton*, 267 Fed. 231, 236 (D. S. D. N. Y. 1920) and *Monroe Gas Light & Fuel Co. v. Commission*, 292 Fed. 139, 143, 144 (E. D. Mich. 1923). *Cf. Brandeis, J.*, dissenting in *Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U. S. 276, 294-296, 43 Sup. Ct. 544, 548-549 (1923).

²⁸ *Chicago, R. I. & P. Ry. v. State*, *supra* note 25. *Cf.* the statement of the court in a rate valuation case, speaking of cost of reproduction and

felt that a possible range of sums is set by the results of the several methods and the other relevant data, and that almost any sum within that range is a permissible one. Other courts, while giving a sort of lip service to the "eclectic" method show clearly that they favor some particular method above the others, using the others merely to satisfy the formality of "considering" all relevant data.²⁹ A favorite combination consists of the capitalization of net earnings and the stock-and-bond (market value of securities) methods.³⁰

The datum that overshadows all others³¹ except the market value of securities, however, is earnings; and by far the most favored method is capitalization of net earnings. Even the stock-and-bond method derives much of its prestige for validity from the fact that security values depend largely upon earnings, although one of its superior virtues, it will be seen, is supposed to lie in the fact that in some cases it reflects factors not shown by earnings. Although they are generally used in connection with other data, no one could fail to perceive from reading the general run of cases that, in spite of occasional expressions of distrust,³² much the greatest reliance is placed on earnings; and in some cases, capitalization of net earnings has been the sole

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original cost: "It would be understandable to say that the two estimates should be averaged, but such a rule could obviously command no support, because it would correspond to no relevant considerations of policy." Consolidated Gas Co. v. Newton, *supra* note 27, at 236.

²⁹ Chicago & N. W. Ry. v. Eveland, 13 F. (2d) 442 (C. C. A. 8th, 1926), cert. granted, 273 U. S. 680, 47 Sup. Ct. 112 (1926), writ dismissed, 273 U. S. 775, 47 Sup. Ct. 332 (1927) (stock and bond method mainly relied on); Mobile & O. R. R. v. Schnipper, 31 F. (2d) 587 (E. D. Ill. 1929) (net earnings).

³⁰ State v. Pullman Co., *supra* note 3; Illinois Central R. R. v. Greene, 244 U. S. 555, 37 Sup. Ct. 697 (1917); Chicago & N. W. Ry. v. Eveland, *supra* note 29.

³¹ Some of the other kinds of data may be laid out of account because their use has been too scanty to warrant extended treatment. Among these are the price at which property has been sold and original cost. The former, while the most realistic market value likely to be attained if the time of sale is close to the day of assessment, is too seldom available to be of much importance. It has been used. See Marshalltown Light, Power & Ry. Co. v. Welker, 185 Iowa 165, 170 N. W. 384 (1919). Of course, if the sale is forced, the sale price is of no value. See Harris Trust & Savings Bank v. Earl, *supra* note 25, at 619.

Original cost is also of decidedly minor importance and has been rejected in some cases. Cincinnati Southern Ry. v. Guenther, 19 Fed. 395 (C. C. Tenn. 1884), Oklahoma Gas & Electric Co., *supra* note 3. For the nature of its application when used, see State v. Central Pac. Co., 10 Nev. 47 (1875), quoted with approval in Great Northern Ry. v. Okanogan County, 223 Fed. 198 (E. D. Wash. 1915).

For reproduction cost, see *infra* note 75.

³² Standard Oil Co. v. Howe, 257 Fed. 481 (C. C. A. 9th, 1919); cf. Opinion of the Justices, 220 Mass. 613, 108 N. E. 570 (1915).

method employed.³³

Because of its importance, the method merits some consideration in detail.³⁴ Briefly stated, it consists in the ascertainment of net earnings, often a rather difficult task; assuming a rate, the one adopted usually being considered a fair rate of return on the property; and capitalizing the earnings,—that is, dividing the net earnings by the rate, the quotient representing the sum which, at the fair return, yields the net income actually realized. That sum is taken to be value.³⁵ Some of the difficulties that beset the way of this method are worth noting.

What are net earnings?

Roughly speaking, gross earnings minus certain deductions, mainly operating expenses, equal net earnings. Although it has been asserted that actual earnings are not necessarily the proper basis of calculation under this method, but rather what the earnings would have been under competent management,³⁶ most courts have been satisfied to use actual earnings. But they must be earnings; it is not sufficient in calculating earnings to use

³³ "It is true that no statute prescribes the net earnings rule as the method by which the value of a special franchise is to be computed, nor is there any decision of the courts that this method is to be exclusively adopted. It is also true that that method of computation is not universally applicable. Nevertheless, in ordinary cases it is the best practical method that the taxing officers and the courts have as yet been able to evolve." Cullen, J., in *People ex rel. Hudson & M. R. R. v. State Board of Tax Com'rs*, 203 N. Y. 119, 130, 96 N. E. 435, 439 (1911); *Louisville & N. R. R. v. Greene*, 244 U. S. 522, 37 Sup. Ct. 683 (1917); *Chicago, I. & L. Ry. v. Lewis*, 12 F. (2d) 802 (E. D. Ky. 1925); *Baton Rouge Electric Co. v. Board of State Affairs*, 149 La. 383, 89 So. 244 (1921); *People ex rel Third Ave. R. R. v. State Board of Tax Com'rs*, 212 N. Y. 472, 106 N. E. 1041 (1914); *State v. Virginia & T. R. R.*, 24 Nev. 53, 50 Pac. 607 (1897); *Oregon & C. R. R. v. Jackson County*, 38 Ore. 589, 64 Pac. 307 (1901), order modified, 38 Ore. 589, 65 Pac. 369 (1901) (valuation of road-bed).

³⁴ The method used under the Kentucky statutes, which have occasioned more valuation litigation, perhaps, than those of any other state with the exception of New York, will serve well as an example. Suppose a railroad is to be valued. The first step is to determine the value of the total corporate property—"total capital stock" as it is called—by capitalizing net earnings at an assumed rate. To Kentucky is apportioned a share of the sum so determined on the basis of track mileage, *i.e.*, the proportion that the miles of track of the railroad in Kentucky bear to the total track mileage of the company. From the sum so apportioned is deducted the assessed value of the tangible property in the state, tangible property being separately assessed by different authorities. The sum remaining is taken to be "franchise" or intangible value. *Louisville & N. R. R. v. Greene*, *supra* note 33. In other jurisdictions there are a number of variations on these steps to reach the same end.

³⁵ For a consideration of fact and theory in great detail in particular cases, see the chapters entitled "Capitalized Earning Power as Evidence of the Value of Property," in DODD, *STOCK WATERING* (1930).

³⁶ *Harris Trust & Savings Bank v. Earl*, *supra* note 25; *State v. Virginia & T. R. R.*, *supra* note 33.

dividends since they may have been paid out of surplus.³⁷

Deductions from gross earnings have contributed a number of issues to litigation, each comparatively insignificant, in itself, but cumulatively important. Maintenance, depreciation, and obsolescence head the list.³⁸ Others are income from the securities of other companies,³⁹ income from tax exempt securities,⁴⁰ rent from real estate in other jurisdictions,⁴¹ expenses incurred in the sale of securities,⁴² and interest on borrowed money invested in plant.⁴³ This list, while not exhaustive, conveys some idea of the elements that may be contested at this point.

Where do courts get the rate which they use as the divisor in the capitalization process? The rate is a peculiarly vital element in the process; five *per cent* instead of six may make a difference

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³⁷ People ex rel. Consolidated Gas Co. v. Feitner, 78 App. Div. 313, 79 N. Y. Supp. 975 (1st Dep't 1903).

³⁸ Failure to make deductions for these items is, of course, error. Baton Rouge Electric Company v. Board of State Affairs, *supra* note 33; People ex rel. Jamaica Water Supply Co. v. Tax Com'rs, 196 N. Y. 39, 89 N. E. 581 (1909) (allowance had been made for depreciation, but not for maintenance). It has been held that in the absence of evidence as to depreciation, it would be presumed to have been cared for out of current operating expenses. In re Oklahoma Gas & Electric Co., *supra* note 3. Straight line method of computing depreciation has been approved by use. People ex rel. Central Hudson Gas & Electric Co. v. State Tax Comm., 218 App. Div. 44, 217 N. Y. Supp. 707 (3d Dep't 1926), *modified* and *aff'd* 247 N. Y. 281, 160 N. E. 371 (1928); Lake Charles Ry., Light & Waterworks Co. v. Reid, 152 La. 476, 93 So. 743 (1922); but *cf.* Baton Rouge Electric Co. v. Board of State Affairs, *supra* note 33. As the case last cited points out, looseness of terminology is so abundant in discussions of these items that it is not always clear what courts mean when discussing them.

³⁹ If the securities are held to be a part of the unit making up the business, income from them cannot be deducted from gross earnings. Chicago, I. & L. Ry. v. Lewis, *supra* note 33. No good criterion has been developed as to when such securities are a part of the unit. The argument that they should be held part of the unit because they enhance credit did not prevail in Fargo v. Hart, 193 U. S. 490, 24 Sup. Ct. 498 (1904); *cf.* the Lewis Case at 806.

⁴⁰ Such securities may not at the time be producing income, so that when deductions are made from gross earnings, no deductions for very valuable property which is exempt will result if the only way for providing such exemption is the deduction of the income from such property. The Supreme Court has nevertheless upheld an assessment which allowed only in that way for tax exempt securities. Louisville & N. R. R. v. Greene, *supra* note 33.

⁴¹ Such rent is of course a proper deduction. Chicago, I. & L. Ry. v. Lewis, *supra* note 33.

⁴² Where income attributable to tangible property is separated from that attributable to intangible property an amount set aside for amortization of expenses incurred in the sale of bonds is not deductible from income attributable to intangibles because the fair return on tangibles should include it. People ex rel. Central Hudson Gas & Electric Co. v. State Tax Comm., 247 N. Y. 281, 160 N. E. 371 (1928).

⁴³ Lake Charles Ry., Light & Waterworks Co. v. Reid, *supra* note 38.

of millions in the quotient. Yet, unaccountably, this issue has not been as much contested as some of the others. The rate is often simply assumed without discussion.⁴⁴ The Supreme Court seems to have put its imprimatur upon any way of arriving at the rate, including that of mere assumption of it.⁴⁵ In an earlier day, when these cases were sometimes tried to juries, the question of the proper rate, together with many other questions, was left to the jury.⁴⁶ In one case the assessors reached a rate "by taking the plaintiff's mileage in each of the States in which it operates, multiplying this by the legal rate of interest in that State, and dividing the total of the products by the total mileage . . .;" and to counsel's objections the court answered merely that their criticisms were directed at "the conclusion of the Board upon a question of fact which is not properly subject to review by the courts."⁴⁷ Another federal court, rejecting the contention that the rate of capitalization should be the same as the rate of interest payable on the road's first mortgage bonds, adopted a rate approved in the Interstate Commerce Act.⁴⁸ In a case where the assessment of tangibles was separate from the assessment of intangibles, and one of the issues was the proper rate of return on the tangibles, one court talked in terms found usually in rate-making valuations, and relied largely upon a rate-making decision.⁴⁹ The court declared that judicial notice might be taken of the rate required to induce investors to put their money into enterprises of the kind in question; and that while it is proper to take evidence on the point, if the parties see fit to offer it, the court could assume the rate if no evidence were offered.

In jurisdictions in which tangibles are assessed separately from intangibles,⁵⁰ the issue also arises sometimes whether the

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⁴⁴ *Martineau v. Clear Creek Oil & Gas Co.*, 141 Ark. 596, 217 S. W. 807 (1920); *Baltimore & Ohio S. W. R. R. v. Commonwealth*, *supra* note 25; see *In re Oklahoma Gas & Electric Co.*, *State v. Pullman Co.*, both *supra* note 3.

⁴⁵ *Illinois Central R. R. v. Greene* *supra* note 30, in which Pitney, J., at 562, 37 Sup. Ct. at 700 said: "The District Court properly held . . . that no fundamentally wrong principle was involved in determining . . . what rate of interest should be used in capitalizing . . ."

⁴⁶ *State v. Virginia & T. R. R.*, *supra* note 33. The jury heard some evidence, although not a great deal, bearing on the rate of interest on investments of this kind. The evidence varied from 6 to 12 *per cent*; the jury found 6, and the court held them to be justified in their finding.

⁴⁷ *Louisville & N. R. R. v. Greene*, *supra* note 33, at 542, 37 Sup. Ct. at 692.

⁴⁸ *Mobile & O. R. R. v. Schnipper*, *supra* note 29.

⁴⁹ *People ex rel. Jamaica Water Supply Co. v. Tax Com'rs*, *supra* note 38.

⁵⁰ Practice differs in the matter of assessing intangible values separately assess both together. The whole property is valued as a unit and an from tangible. A number of jurisdictions do not consider them apart but

rate of return to be used as a divisor should be the same for each. Different answers have been given. Louisiana holds that the rate ought to be the same;⁵¹ New York, that the rate on intangibles should be a little higher in order "to provide against unforeseen contingencies that may arise in the prosecution of the business of the corporation."⁵²

The other leading method of valuation, the stock-and-bond method, has encountered unusually variant climates of opinion. Discussion of it in cases turns on a usually final issue: Shall it be employed at all? The essence of the method and the expression of approval are happily united in language of Mr. Justice Miller's that has become classical:

"It is therefore obvious, that, when you have ascertained the current cash value of the whole funded debt, and the current cash value of the entire number of shares, you have, by the action of those who above all others can best estimate it, ascertained the true value of the road, all its property, its capital stock, and its franchises; for these are all represented by the value of its bonded debt and of the shares of its capital stock."⁵³

Although not all courts have thought so highly of the gentlemen who deal in securities,⁵⁴ the method has by and large found wide favor. The statutes of some states specifically provide for its use;⁵⁵ and it has received special praise in a few cases,⁵⁶

apportionment made to the taxing jurisdiction of its share of the total value. See *Mobile & O. R. R. v. Schnipper*, *supra* note 29. Other jurisdictions first assess tangibles, apply the rate to their value, deduct the sum so found from total net earnings and capitalize the remainder to find the value of intangibles. *People ex rel. Hudson & M. R. R. v. State Board of Tax Com'rs*, *supra* note 33; *Lake Charles Ry., Light & Waterworks Co. v. Reid*, *supra* note 38.

⁵¹ *Baton Rouge Electric Co. v. Board of State Affairs*, *supra* note 33; *Lake Charles Ry., Light & Waterworks Co. v. Reid*, *supra* note 38.

⁵² *People ex rel. Manhattan Ry. v. Woodbury*, 203 N. Y. 231, 96 N. E. 420 (1911) (2 judges dissenting).

⁵³ *State Railroad Tax Cases*, *supra* note 4, at 605.

⁵⁴ "To the person familiar with such matters it is well known that stocks and bonds do not as a rule at any time represent the money actually invested in a property of the character here in question. It is only necessary to note the case of bonds sold below par . . . the fraudulent practice of 'watered stock' . . . the effect of the operations of . . . the bulls and bears of Wall-street . . ." Clark, J., in *Railroad & Telegraph Cos. v. Board of Equalizers*, 85 Fed. 302, 312 (C. C. Tenn. 1897). For language of the same tenor, see *Chicago Union Traction Co. v. State Board of Equalizers*, 112 Fed. 607, 612 (C. C. Ill. 1901).

⁵⁵ *Western Union Tel. Co. v. Taggart*, 163 U. S. 1, 16 Sup. Ct. 1054 (1896) (use directed by Ind. Stat.); *Western Union Tel. Co. v. Massachusetts*, 125 U. S. 530, 8 Sup. Ct. 961 (1888) (provided for by Mass. statutes).

⁵⁶ *Chicago & N. W. Ry. v. Eveland*, *supra* note 29; see *Chicago, R. I. & Pac. Ry. v. State*, *supra* note 25.

particularly those having to do with corporations with wasting assets.⁵⁷ The particular issues arising in the use of this method do not merit extended separate consideration.⁵⁸

If this quick view of the methods in the abstract, isolated from impinging forces, has endowed them with an air of workability or even of simplicity, a view of them in truer perspective, functioning in the system, robs them of their virtuous guise. Wide variations in the sums resulting from the several methods, customarily used together, is the rule rather than the exception. Reliance on the results of a single method afford no escape from variations; for a wide range of sums may result from the use of a single method. Consider, for example, that in the use of the net earnings method the rates assumed might be either five or six *per cent*, and that the earnings figures used might be either those for the year preceding the assessment or an average of earnings over the preceding five years. The permutations of these data give four sums with a range that may be so wide as to deprive them of nearly all meaning.

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⁵⁷ *Cumberland Pipe Line Co. v. Lewis*, 17 F. (2d) 167 (D. E. D. Ky. 1926); *Floyd v. Manufacturers' Light & Heat Co.*, 111 Ohio St. 57, 144 N. E. 703 (1924). See *Martineau v. Clear Creek Oil & Gas Co.*, *supra* note 44. Companies with wasting assets present a peculiar problem. As the court in the *Cumberland Pipe Line* case explains, the assumptions underlying the net earnings method do not apply to such companies. It is ordinarily assumed in using past net earnings that future earnings will continue much the same. Obviously this cannot be true of a company with wasting assets. Therefore, it is argued, the stock and bond method is superior in such cases because security values are supposed to reflect the probable life of the wasting assets. On assessment day therefore, the court said that the value was not more than a "... sum which, invested at 6 *per cent*, compounded annually would yield to the purchaser the sum total of such net income during each of those years, and the market value of any assets that the plaintiff owned, not a part of its pipe line system."

⁵⁸ Since stock market quotations are the measure of the market value of the stock, some other means must be used to arrive at market value if the stock happens not to be on the market. One substitute has been expert testimony as to what the stock would or ought to sell for in the market in the light of its earnings per share. *Mobile & O. R. R. v. Schnipper*, *supra* note 29. Then again, some but not all of the company's shares may be on the market, and the argument has been made that on that account market quotations led to too high a valuation. The argument did not prevail. *Western Union Tel. Co. v. Taggart*, *supra* note 55.

There is also the question of securities in other companies owned by the taxpaying company. There, as in the earnings method, the test is the vague one of closeness of relationship. The relationship is not closer merely because the company has deposited the securities with a trustee and issued its own securities against them. *Coulter v. Weir*, 127 Fed. 897 (C. C. A. 6th, 1904). The factor there stressed that the securities aided in securing credit because creditors could reach them was held not to make them part of the unit. For a contrary and more modern view, see *Schnipper case*, *supra*.

Part of the blame for variant results, of course, must be charged to the fact that it is a variant world. One of the several important difficulties that must confront any system of assessment is simply the fact of change. One court, with unique and prophetic insight, recognized this in 1861, near the beginning of things.⁵⁹ Values fluctuate, sometimes very violently, as recent experience abundantly illustrates. Many valuation cases represent attempts by courts to fix a stable standard for the measurement of value, some criterion that will resist the flux and change of circumstance. It has not yet been done. New sources of competition develop; wars disrupt economic life; prices rise and fall; earnings swell and dwindle; securities soar and crash; ceaseless change is the rule, and the valuation process must adapt itself to change. The erratic behavior of security quotations has been searingly brought home to everyone. The general economic conditions behind such fluctuations play havoc also with earnings and prices. It is not at all unintelligible, then, why courts have not cared to go into detail as to the nature of the process whereby assessors are to "consider" the relevant data of costs, earnings, and stock-and-bond quotations, and why they have not indicated, except in a very general way in a few instances, what weight ought to be given to different kinds of data. One can begin to see the inexorable necessities that drive courts ultimately to the haven of "discretion" and "judgment."

The fluctuations in business conditions that produce changes in the indices of value may be reflected in corresponding fluctuations in valuation figures.⁶⁰ But since some degree of regularity is desirable, the attempt is occasionally made to flatten out the curve of short time trends in business conditions by using an average of the data for a number of the preceding years. In one case in which the stock-and-bond method was used, the quotations used represented (1) the average for the five years preceding the assessment day, (2) the average for the year preceding that day, (3) the average price on that day.⁶¹ This was a commendable effort; but nowhere is it written that assessors must follow that procedure. Apparently, they may or may not, as they see fit. If they are not disposed to use average prices and choose to use the highest market price during the preceding period the assessment may nevertheless stand.⁶² Hard times

⁵⁹ "Values are fluctuating and changeable, as all experience shows. Nor is it easy, at any one period of time, to lay down a general and satisfactory rate of certain application, in all cases, for the purpose of ascertaining the value of many kinds of property subject to taxation. . . . Such is peculiarly the case with railroad property and other similar property." Breese, J., in *State v. Illinois Central R. R.*, 27 Ill. 64, 68 (1861).

⁶⁰ See *State v. Savage*, *supra* note 3, at 766.

⁶¹ *State v. Pullman Co.*, *supra* note 3.

⁶² *Illinois Central R. R. v. Greene*, *supra* note 30.

may cause net earnings to melt away and disappear. Use of the net earnings method is then, of course, precluded.⁶³ Even though the method be used, however, it is said that in times of depression too great reliance should not be placed upon it.⁶⁴

These considerations suggest the further circumstance of insolvency. Here, even the most conscientious assessor, in attempting to mold his practice to the precepts laid down by the courts, must find himself baffled. The issue is whether any intangible values are to be found in a company that is either insolvent or barely able to pay running expenses. It arose in a lower federal court shortly after the Civil War. With astonishing heat Judge Drummond (of renown, if not of blessed memory, for his use of the labor injunction in administering railroad receiverships)⁶⁵ decided that limping and insolvent roads had no intangible values; and an injunction was granted against enforcement of a tax based on a valuation that included such values.⁶⁶

The Supreme Court, however, reversed the lower court and found the assessment valid.⁶⁷ One of the roads involved could barely pay running expenses, but was assessed \$2,000,000 for intangible values in addition to \$2,600,000 for tangibles. Its stock was worthless. Mr. Justice Miller nevertheless declared the assessment proper; for although the road was not making any profit, its franchises were still worth something, it still had some going-concern value (although the Justice did not call it by that name). The other roads were in like circumstances or worse.

This issue seems to have remained virtually quiescent for nearly fifty years, although from time to time references are found to economic conditions resulting in low earnings by railroads.⁶⁸ In the meanwhile, the Supreme Court did have one occasion to re-affirm the above holding.⁶⁹ Soon after that a case was carried to the Court by the receiver of a Texas railroad who attacked the assessors' valuation of \$39,000,000, of which about \$10,500,000 represented intangible values. The road had undergone a reorganization; and if the earnings for the succeeding year had been capitalized, the resulting sum would have been less than \$1,000,000. The road was again unable to pay fixed

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⁶³ *Southern Ry. v. Kentucky*, 274 U. S. 76, 47 Sup. Ct. 542 (1927).

⁶⁴ *Chicago & N. W. Ry. v. Eveland*, *supra* note 25, at 437.

⁶⁵ See Nelles, *A Strike and its Legal Consequences* (1931) 40 YALE L. J. 507.

⁶⁶ *Jessup v. Chicago & A. R. R.*, Fed. Cas. No. 7,300 (C. C. Ill. 1875).

⁶⁷ *State Railroad Tax Cases*, *supra* note 53.

⁶⁸ See *Railroad and Tel. Cas. v. Board of Equalizers of Tennessee*, 85 Fed. 302, 310 (C. C. Tenn. 1897); *Chicago & N. W. Ry. v. Eveland*, *supra* note 25, at 437.

⁶⁹ See *Ohio Tax Cases*, 232 U. S. 576, 590, 34 Sup. Ct. 372, 375 (1914).

charges, and went into receivership. The Supreme Court, speaking through Mr. Justice Brandeis, found nothing amiss in the assessment and upheld it without discussing the question of whether there was any intangible value in such a road.⁷⁰ Since that had been an issue in the state courts, in which it was finally held that there were such values, inferentially the Supreme Court would seem to have held to its established view.

Finally, in *Southern Railway v. Kentucky*,⁷¹ the Supreme Court again dealt with the issue. Mr. Justice Butler spoke for the court. The road involved was completely controlled by another, and the assessors had valued it as part of a unit together with the controlling road, with which it had a physical operating connection. Considered as a separate operating unit, however, it not merely failed to show net earnings, but showed an actual deficit. The court held the assessment, which plainly included intangible values, to be invalid because arbitrary and excessive.⁷² It is rather astonishing that this was done without so much as citing or referring to the three prior Supreme Court decisions on the matter, or to the early decision of Judge Drummond to the views of which the court had apparently returned. Some of those precedents dealt with roads that were admittedly insolvent, several of them deeply so; and if the courts succeeded in finding intangible values in such roads, it might be supposed that such values could be found in solvent roads.

The importance of this briefly sketched history of the point does not turn on the question of which of the two views is right, although on that score it is submitted that the earlier view of the Supreme Court is the better one.⁷³ The significant thing is

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⁷⁰ *Baker v. Druesedow*, *supra* note 25.

⁷¹ *Supra* note 63. This case had been preceded by a decision in a federal district court concerning a leased road which declared that if gross income did not exceed rent paid plus operating expenses there was no intangible value upon which a tax could be levied. See *Chicago, I. & L. Ry. v. Lewis*, *supra* note 33.

⁷² Mr. Justice Brandeis dissented ostensibly on the basis of the procedural rule that the court could not consider on review issues not raised in the courts below. His language, however, seems to indicate a more fundamental basis. "The importance of the rule of practice is illustrated by the case at bar. Because the reasonableness of the method of assessment was not questioned below, there is nothing in the record to show what figures and what method of calculation were used by the taxing officer. The figures adopted by this court are presented only in the brief of the plaintiff in error. They are protested by counsel for the commonwealth. Moreover, there is reason to believe that the inferences drawn from them are unsound." 274 U. S. at 91, 47 Sup. Ct. at 547.

⁷³ As Mr. Justice Miller argued in the *State R. R. Tax Cases*, why do not the bond holders put up the property piece by piece? Obviously because in doing so they would lose most if not all of the value that arises out of the fact that the property is an operating unit. Cogent also is the argument of the court in *Druesdow v. Baker*, 229 S. W. 493 (Tex. Com.

that it becomes necessary to enter another item in the long catalogue of assessment obstacles and uncertainties. No assessor could proceed upon either view with assurance that he would be upheld. The late unheralded reversal may be merely the precursor of another. Indeed, in the very next year after the Butler opinion the Circuit Court of Appeals for the Eighth Circuit, without mentioning that opinion, upheld a railroad assessment in *Harris Trust & Savings Bank v. Earl*,⁷⁴ that had been attacked as excessive in view of vanishing earnings.

The court in that case found a new ground, however, upon which to sustain the assessment in spite of dwindling earnings. That ground was incompetent management. It is emphasized by five distinct references to it in the course of the opinion. "Earning capacity" to some courts, then, means not what a road is earning, but what it would earn under competent management. In the light of the complexity of present day operating conditions, bus and water competition, automobile competition, which is discussed in the case, as well as a host of other factors, how "earning capacity" is to be found becomes a baffling puzzle, especially the process of allocating to management and to other factors their proper share of responsibility for disappearing earnings. If there were not enough hypothetical elements in the valuation process before, this supplies the final and crowning touch.

III

It is doubtless to be expected not only that the two valuation processes that are carried out on the grandest scale, those for rate-making and for tax assessment, should command more attention than others, but also that between these two there should be some interchange of ideas. Courts and assessors seem, at any rate, to have drawn upon rate-making valuations for ideas.⁷⁵

App. 1921), that the very fact of a receivership attests the existence of intangible values, the preservation of which is the chief task of the receiver. It is safe to assume that no sale of the properties would be made on the basis of the mere junk value of their component parts, yet what else but that is Mr. Justice Butler contending for as the basis of a tax assessment?

⁷⁴ *Supra* note 25.

⁷⁵ The use by some courts of the cost of reproduction new seems to have its source, in some cases, in analogy to rate-making cases. In tax cases its use is barren of the usual arguments accompanying its use in rate cases. The method has received brief approval, *Washington Water Power Co. v. Kootenai County*, 270 Fed. 369 (C. C. A. 9th, 1921); *Long Dock Co. v. State Board of Assessors*, 89 N. J. L. 108, 97 Atl. 900, aff'd, 90 N. J. L. 701, 101 Atl. 367 (1916); cf. *People ex rel. Jamaica Water Supply Co. v. Tax Com'rs*, *supra* note 38; and also high praise. See Clark, J., in *Railroad & Telephone Cos. v. Board of Equalizers*, *supra* note 68, at 313. Some courts have dismissed the method with little or no discussion. Chicago

On the issue whether the reports of a railroad to the Interstate Commerce Commission are admissible evidence in a tax valuation, there have been holdings both ways.⁷⁶ Courts have availed themselves of the Commission's data: its rate of capitalization is of influence in the net earnings method; and expert testimony, common in tax valuations as it is in others of all kinds, is sometimes based on the Commission's price, cost, and other data.⁷⁷ But more important than other contacts between the two kinds of valuations is the insistence by some that value for both purposes is identical. This notion has had the support of referees appointed to take evidence on the issue of value,⁷⁸ of certain courts,⁷⁹ and of at least one legislature, which for a time embodied it in statutes.⁸⁰

& N. W. Ry. v. Eveland, *supra* note 29; Atchison, T. & S. F. Ry. v. Sullivan, *supra* note 3 (method rejected because it excludes intangible values which may be greater than tangible); though its use be recognized as proper, it will not be considered if depreciation is wrongly calculated, State v. Western Union Telegraph Co., *supra* note 3, or if a formula invoked in an attempt to take changing price levels into account is found to be too complex and arbitrary. See Mobile & O. R. R. v. Schnipper, *supra* note 29. On the whole this method in tax valuations is quite unimportant.

⁷⁶ That they are admissible: People ex rel. Lehigh Valley Ry. v. Burke, 221 App. Div. 248, 223 N. Y. Supp. 168 (4th Dep't 1927); Chicago, R. I. & P. Ry. v. State, *supra* note 25; see Chicago Great Western Ry. v. Kendall, 266 U. S. 94, 100, 45 Sup. Ct. 55, 57 (1924). That they are not admissible: Atchison, T. & S. F. Ry. v. Sullivan, *supra* note 3; Chicago & N. W. Ry. v. Eveland, *supra* note 29.

⁷⁷ Mobile & O. R. R. v. Schnipper, *supra* note 29; see Chicago R. I. & P. Ry. v. State, *supra* note 25.

⁷⁸ In re Assessment of Western Union Telegraph Co., *supra* note 3. The referee had concluded "... as a matter of law that the valuation of property for the purpose of rate making within the state, and the valuation of property for the purposes of taxation should be one and the same." The court decided that he had erred in giving too much weight to the value for rate-making purposes, and upheld the assessors' valuation of \$1,450,684 as against the referee's finding of \$414,481, which was approximately the rate-base figure.

⁷⁹ Washington Water Power Co. v. Kootenai County, *supra* note 75; Railroad and Telephone Cos. v. Board of Equalizers, *supra* note 68; Mobile & O. R. R. v. Schnipper, *supra* note 29; State v. Savage, *supra* note 3, at 755, 91 N. W. at 724, where the court said: "The property can have but one true value, whatever may be the purpose of the investigation."

⁸⁰ See State ex rel. Oregon R. R. & N. Co. v. Clausen, 63 Wash. 535, 116 Pac. 7 (1911); Spokane & I. E. R. R. v. Spokane County, 75 Wash. 72, 134 Pac. 688 (1913), writ of error dismissed, 238 U. S. 642, 35 Sup. Ct. 284 (1914); Oregon-Washington R. R. & N. Co., v. Thurston County, 98 Wash. 218, 167 Pac. 930 (1917), writ of error dismissed, 246 U. S. 678, 38 Sup. Ct. 335 (1918).

The legislature apparently sought to retreat from the iron-bound rule of these cases by modifying the language of the earlier statute, which made the findings of the Public Service Commission conclusive evidence of the facts stated in such findings, by inserting the clause "except as a basis for taxation." The later form also omits the earlier provision that

Although it does not appear that the Supreme Court has spoken on this issue, it is noteworthy that Mr. Justice Butler has long been a leading advocate of the idea that value for different purposes is the same. In one of the cases in which he appeared as counsel for a railroad, before his appointment to the bench, he contended that "value" means economic value—"Value is power in exchange"—; he identified value for rate-making purposes with value for purposes of taking property in condemnation proceedings, and he declared that "... in stating the rule for determining value in general terms it is difficult to improve on the statement in *Smyth v. Ames*."⁸¹ It was also contended that "... so far as the property is used in transportation service or is taken in condemnation, its value at the same time is the same whether the inquiry may relate to rates or eminent domain or assessment for taxation or capitalization."⁸² One is prepared to find, therefore, that in support of the court's decision on one of the main issues in *Southern Railway v. Kentucky*, a tax valuation case, Mr. Justice Butler cited *Smyth v. Ames*⁸³ and a case in which one of the issues was the price to be paid by a city for a local utility upon exercising an option to purchase.⁸⁴ The Justice was not alone in his views on the identity of values, for his brethren among railroad counsel were urging the same notions.⁸⁵ If, then, owing to the assiduity of these men, some courts have been brought around to their views, any sympathy that might be felt for railroads on account of their tax burden must be tempered by the knowledge that they labored to bring it upon themselves. "Perhaps the valuation counsel were not completely aware, in taking this position, that they were forging a two-edged sword which might be used against them in tax cases, or perhaps they were aware of this fact, but were willing to accept the danger of higher tax assessments in order to gain the much greater benefit of permission to charge higher railway rates."⁸⁶ In neither event does one feel that the

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value as found by the commission should be taken as value for assessment and taxation. Compare the earlier form as set out in the Clausen Case above, with WASH. COMP. STAT. (Remington, 1922) § 10,441. There is nothing, however, to prevent assessors and courts from using rate-making value if they see fit.

⁸¹ Tunnell, *Value for Taxation and for Rate-Making* (1927) 35 JOUR. POL. ECON. 1, 19-22, quoting from a brief of 1027 printed pages presented by Mr. Justice Butler and Mr. Leslie Craven to the Interstate Commerce Commission on behalf of the Texas Midland R. R., 75 I. C. C. 1 (1918).

⁸² Tunnell, *op. cit.* *supra* note 81, at 22.

⁸³ 169 U. S. 466, 18 Sup. Ct. 418 (1898).

⁸⁴ *City of Omaha v. Omaha Water Co.*, 218 U. S. 180, 30 Sup. Ct. 615 (1910).

⁸⁵ Tunnell, *op. cit.* *supra* note 81.

⁸⁶ Bonbright, *May the Same Property Have Different Values for Different Purposes?* NAT. TAX ASS'N PROCEEDINGS (1927) 279, 289.

railroads have been much abused so far as taxation is concerned.

In the great majority of cases, no mention is made of valuation for rate-making purposes; the inquiries are carried on entirely independently and without correlation. Thus it happens that while the object of inquiry in both types of valuation is "value," the results are quite disparate.⁸⁷ Examples could be multiplied; one of the more interesting ones, *Chicago & N. W. Ry. v. Eveland*,⁸⁸ decided by a court which explicitly rejects the notion of the identity of value for rate-making and taxation purposes, must suffice. The road, objecting to the amount at which its property had been assessed, paid taxes on a basis of a value of \$29,183,208 or about 70% of the state's figure, and brought suit for an injunction against collection of any amount based on a higher assessment. The road's value figure was allowed to stand because it most nearly approximated the results of the methods that have in the long course of tax usage come to be the beaten pathway to value. It is illuminating to note the other values that had been placed on the road and their fate in the trial ordeal. The \$52,467,000 at which the road carried the property on its books was dismissed on the ground that it represented cost and not value. The sum of \$47,528,900 which appeared in the road's own report to the state tax commission was brushed aside because it was based on cost of reproduction with no allowance for depreciation, and also because the same report contained much lower figures by the company's experts under the heading "fair cash value." The Interstate Commerce Commission's engineers had valued the road at \$35,500,000, a sum which, at the time, the road had claimed to be too low by \$6,651,000. This sum the court dismissed by saying that "these valuations were not for the purposes of taxation, wherein use for railroad purposes and market value of stocks and bonds are chief factors, but for rate-making purposes, wherein a very different basis for valuation prevails." Also that "those valuations were based on prices and costs—not on value for taxation or sale."⁸⁹ The two conflicting

⁸⁷ Tunnell, *op. cit. supra* note 8, at 274, reports a case in which the Interstate Commerce Commission valued railroad property at \$540,000; a number of years later the assessors valued it at \$56,400. Shortly thereafter it was sold for \$25,000. At p. 273, he reports another case in which the I. C. C. valuation was \$1,365,000 in 1916; the road was assessed at \$231,400 in 1925, and \$406,450 in 1926, years of much higher price and wage levels than 1916. Shortly before the 1926 assessment, the road sold for \$700,000. According to Tunnell's report, the state is one in which assessors are directed by law to follow the findings of the I. C. C., but when assessors did so, the road brought suit in the Supreme Court of the state for a reduction, and succeeded in getting one to the level of the previous year.

⁸⁸ *Supra* note 29.

⁸⁹ *Ibid.* 445.

views on this issue would, in the light of the fact that the Supreme Court refused to review the *Eveland* case and has not formally passed on the question, make it appear that counsel who wish to introduce evidence of value for rate-making in a tax valuation case will first be obliged to ascertain the attitude prevailing in their particular circuit or even in a particular court.

The chief arguments advanced by courts that believe that the two values ought to be the same center about the specious though superficially appealing fairness and justice of holding them the same, and the supposed consequence that companies will be restrained from claiming too high a valuation because of taxes and too low a valuation because of rates. These ignore the obvious consideration that generally the privilege of charging higher rates far outweighs the risk of higher taxes. There is, it may be conceded, something that clashes with the prevailing sense of the fitness of things in the spectacle of a company striving mightily for high rate and low tax valuations. But this clash may be traced to a confusion of thought, to be found on all levels of thinking about valuation matters, resulting from the use of "question begging epithets."⁹⁰ To fix a rate base is one thing; to fix a tax base quite another. Unfortunately, the word "valuation" is part of our verbal currency in talking about both processes. The mere fact that both are called "valuation" is enough to account for much confusion. As a matter of theory, the difference in function that is being performed by courts in the two valuations is a sufficient explanation, and also a justification, if any were needed, for the disparity between the values found in the two kinds of processes. Courts in rate cases are not *seeking* value, they are *creating* it.⁹¹ As a practical matter, the reason for differences in the two values is often to be found in the simple fact that no two bodies of men would value the same properties in the same way or with like results. The sheer clumsiness of our contrivances for control are quite as much part of the picture as diligent self-seeking by the "interests;" for tax valuations have not infrequently been much greater than rate valuations in the past, and there is no reason to doubt that they will sometimes be so in the future.

IV

More important practically than most of the substantive elements of this piece of tax machinery are the so-called procedural

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⁹⁰ See Hadley, *The Meaning of Valuation* (1928) 18 AMER. ECON. REV. 173, 176.

⁹¹ See Bonbright, *op. cit. supra* note 7, at 502-506; Greencastle Waterworks Co. v. Public Service Commission, 31 F. (2d) 600 (S. D. Ind. 1929).

elements; for these probably hold the true inwardness and the deeper significances of the whole matter.

That public utilities and similar corporations are sometimes known as public service corporations and are said to be affected with a public interest does not obscure the fact that their primary goal is still profit. All can understand, therefore, although many would condemn, their use of the machinery of the law to enhance profits. They were not the first to discover that the capital use value of money is, in many instances, much greater than the cost of the litigation by which ultimate payment may be postponed. There is always the chance, moreover, that out of the gamble of litigation, particularly over so complex a matter as a tax assessment, they may emerge the winners. They may never be obliged to pay the money at all.

The practice, at least in earlier times, was the simple one of procuring an injunction against the collection of any of the tax pending a judicial determination of the amount due. Obviously enough, if the amount due, though disputed, were large, the law's delays allowed the tax money to earn interest far in excess of court costs. Mr. Justice Miller did what he could in the *State Railroad Tax Cases* to end the practice by calling attention to it, denouncing it, and suggesting a partial remedy. He held that the company "must first pay what is conceded to be due, or what can be seen to be due on the face of the bill, or be shown by affidavits whether conceded or not, before the preliminary injunction should be granted."⁹² That was in 1875. The justice was too sanguine about the success of his remedy. He was "satisfied that an observance of this principle would prevent the larger part of the suits for restraining collection of taxes which now come into the courts." He could not foresee the immense growth in number and size of corporations and corporate properties of all kinds that was shortly to ensue. Though he then thought the tax demands of state and nation heavy, he could not foresee their manifold increase. It cannot be doubted, therefore, that in many instances it still remains profitable to restrain collection of the amount of the tax beyond that "conceded" to be due.⁹³ An estimate of the present extent of the practice is a matter of conjecture and speculation.

Courts have not been without insight into the problems confronting assessors. Assessors are, after all, human beings struggling as best they can to perform a certain task with inadequate tools. They are not to blame if industrial growth outstripped that of the tax system so that their task is like attempting to cover a full grown man with a child's garments. It is not their

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⁹² *Supra* note 4, at 617.

⁹³ This is clearly illustrated in *Chicago Great Western Ry. v. Kendall*, *supra* note 76.

fault that what statutes have set them to measure does not exist as to public utilities, so that their nominal task is impossible; nor that the statutes have supplied definitions that fail to define. So far as assessors' fault as a source of difficulty is concerned, downright fraud is entirely negligible and has no place in the discussion. Of ineptitude there has been some, but not enough to account for more than a small part of assessment troubles. Mr. Justice Miller, after recognizing in part the imperfection of the system, was also moved to say:

"The application being made by men whose judgments and opinions must vary as they are affected by all the circumstances brought to bear upon each individual, the result must inevitably partake largely of the imperfection of human nature, and of the evidence on which human judgment is founded."⁹⁴

This attitude he shared with other judges and other courts. The mere fact, therefore, that counsel are able to discover to the court some of the imperfections that must inevitably characterize assessments is not a reason for scrapping the assessment. Hence we find the following statement, or one of like tenor, appearing in these cases with pious regularity:

"The findings of an official body such as the Board of Valuation and Assessment, made . . . after a hearing and upon notice to the taxpayer, are *quasi*-judicial in their character, and are not to be set aside or disregarded by the courts unless it is made to appear that the body proceeded upon an erroneous principle or adopted an improper mode of estimating the value of the franchise or unless fraud appears."⁹⁵

This is a very dubious kind of principle. It probably worries company counsel very little. If Mr. Justice Holmes or a like minded judge happens to be enunciating it, then, indeed, counsel may be very certain that the assessment will stand unless something is profoundly and radically wrong.⁹⁶ On the other hand, it will not unduly tax the ingenuity of any court, if for any reason it disagrees with the assessment, to find that the assessment is based on a "fundamentally erroneous principle."

The above rule, however, has been bolstered by another: the mental processes of assessors during the valuation cannot be inquired into later by cross-examination of members of the assessing body. Assessors have in many cases been very secretive

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⁹⁴ State Railroad Tax Cases, *supra* note 4, at 612.

⁹⁵ Pitney, J., in *Louisville & N. R. R. v. Greene*, *supra* note 33, at 536, 37 Sup. Ct. at 690.

⁹⁶ See, for example, the opinion in *Chicago B. & Q. Ry. v. Babcock*, 204 U. S. 585, 27 Sup. Ct. 326 (1907).

about their methods, disclosing nothing of how they reached their results. What is more, Mr. Justice Holmes held in an opinion reminiscent of the classic *Lochner* dissent, they cannot be made to tell. In *Chicago, B. & Q. Ry. v. Babcock*,⁹⁷ counsel for the company having argued that the assessors were arbitrary at various points, the Justice said:

"But the action does not appear to have been arbitrary except in the sense in which many honest and sensible judgments are so. They express an intuition of experience which outruns analysis and sums up many unnamed and tangled impressions; impressions which may be beneath consciousness without losing their worth. The Board was created for the purpose of using its judgment and knowledge. . . . Within its jurisdiction, except, as we have said, in the case of fraud or a clearly shown adoption of wrong principles, it is the ultimate guardian of certain rights. The State has confided those rights to its protection and has trusted to its honor and capacity as it confides the protection of other social relations to the courts of law. Somewhere there must be an end. We are of opinion that whatever grounds for uneasiness may be perceived nothing has been proved so clearly and palpably as it should be proved . . . in order to warrant these appeals to the extraordinary jurisdiction of the Circuit Court."⁹⁸

Thus the judicial formula, as set down by our greatest jurist, amounts in practice to this, that we must put our trust in the servants of the state, and for the rest trust in God. It might well be that in time nearly everyone could become reconciled to reliance on the "intuition of experience that outruns analysis"—if only it were true that experience is enough to bring to the problem. That, unfortunately, has proved to be untrue.

One of the consequences of the policy of secrecy and the rule upholding it is to throw the valuation burden in a contested case very largely on the courts, who are ill-equipped and not properly organized to cope with it.⁹⁹ When the valuation issue gets to

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⁹⁷ *Supra* note 96.

⁹⁸ *Ibid.* 596, 27 Sup. Ct. at 329.

One jurisdiction, at least, has long dissented from Mr. Justice Holmes' view. *Consolidated Gas Co. v. Baltimore*, 105 Md. 43, 65 Atl. 623 (1907); *Susquehanna Power Co. v. State Tax Commission*, 159 Md. 359, 151 Atl. 39 (1930).

⁹⁹ *Cf.* Comment (1930) 40 Yale L. J. 81. Indeed, we have judicial confession of the fact in a tax case, *United New Jersey R. R. Canal Co. v. State Board of Taxes and Assessment*, 100 N. J. L. 131, 136, 125 Atl. 335, 336, 337 (1924), in which the court, commenting on a statutory provision that assessors should be "entitled to use their personal knowledge and judgment as to the value of property," said: "It is quite obvious in reading this bewildering and confusing record what (the) purpose was. The record in this case is an apt illustration of the wisdom of the legislature in inserting such a provision in the statute."

law, oftentimes all that the court has to review is a sum,¹⁰⁰ and the issue takes this form: Is the sum so far from value that it indicates the use of a fundamentally erroneous principle in the valuation process? The trial court must then either invoke the aid of a referee to take evidence, or take the voluminous evidence itself. On review by appellate courts, then, the opinions are concerned largely with valuation methods sanctioned by lower courts and referees instead of methods used by assessors. The history of an assessment might run something like this: (1) report of the company to the assessing body stating the company's valuation of its own properties; (2) assessment by the official body; (3) finding by a referee on direction of the trial court; (4) approval, modification, or rejection by the trial court; (5) if the trial court is a state court, appeal to the highest state court; or, if the trial court is a federal court, appeal to the Circuit Court of Appeals; (6) appeal to the United States Supreme Court. Probably the notions of value and valuation of no two persons concerned in the long ordeal of the law begin to coincide.¹⁰¹

Behind these rules, designed to keep an assessment firmly standing if possible, one senses something more fundamental than judicial recognition of imperfections in tax systems and human frailties in assessors. Self-preservation is the first law not only of nature but also of states. Our judges have been blessed with foresight of the disastrous consequences that must ensue from a tying up, from whatever cause, of too large a proportion of the revenues.¹⁰² The recent experience of certain states and municipalities has dramatically proved judges' fears to be well founded. "It takes revenue to maintain the state government and the subdivisions thereof," said one court revealingly, "... and where it appears to this court that all the provisions of law relative to making the levy have been substantially complied with, we will hold the levy valid."¹⁰³ The conjunction of these two ideas is surely not without significance. The sharper and more pressing the judicial awareness of the difficulties of assessment under prevailing methods, the more apparent becomes the necessity for rules and presumptions to uphold assessments. The assessor's task is formidable; his tools are outmoded and inadequate; the pitfalls along the way are innumerable. In proportion as these things are true, the less enlightened can be the justice administered in these tax cases if governments are to have money with

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¹⁰⁰ Cf. the language of Mr. Justice Brandeis quoted *supra* note 73.

¹⁰¹ See *Detroit Citizens' Street-Railway Company v. Common Council of Detroit*, 125 Mich. 673, 705, 85 N. W. 96, 107 (1901).

¹⁰² See *Chicago Great Western Ry. v. Kendall*, *supra* note 76, at 97, 101, 45 Sup. Ct. at 56, 57.

¹⁰³ *Bonaparte v. Nelson*, 142 Okla. 54, 59, 285 Pac. 100, 104 (1929).

which to function. The materials available to counsel out of which to fashion a case against an assessment are unusually abundant. The possible points of attack are many. It becomes plain, therefore, that the system needs some sort of hypodermic in the form of the rules just discussed to "jack it up" and keep it functioning.

Still, the inquirer finds that in spite of these rules a large proportion of the litigated cases result in overthrow or modification of the assessments. Since it cannot be denied that a presumption is a useful judicial device, there is a certain plausibility in the opinion that the presumption of correctness is merely a convenient tool in the hands of judges who happen to be disposed for any reasons to uphold the assessment; but this does not preclude but rather invites inquiry into what forces determine whether the tool shall be used or not. It is not to be doubted that in the interest of the state there is a more or less stiff judicial resistance to attempted revision of assessments, although it may be owned that the stiffness of the resistance varies with the times and with the judges. Yet the clusters of facts that make parties call upon the law for redress are plainly visible on the very fringes of the wilderness of single instance. Some have already appeared in these pages. When the assessment of a railroad leaps from \$6,500,398 to \$12,500,000 in a single year, it is a matter of course that the road will move vigorously to protect itself.¹⁰⁴ When assessors can conclude that a railroad is worth \$365,559,617, while the company admits a value of not more than \$189,185,593, and a commissioner appointed to take evidence on the issue of value can find a value of only \$117,680,202,¹⁰⁵ who can rationally be surprised if the courts radically alter the assessment? Is not the stage set for resort to law when tax authorities value property in June at \$1,492,815 and reply to the company's October protest with a revised value of \$3,700,713, for which they can advance perfectly plausible reasons?¹⁰⁶ These are random samples out of a large company. The presumption, then, and the resistance to which it gives effect is a real force; the many cases in which assessments have been altered attest how uncertain, capricious, and rachitic are the ways of the system.

If there is anything in this analysis, it is idle to decry the rules that leave courts and corporations in the dark as to how assessments were arrived at and require courts to adjudicate disputes in ignorance of some of the vital facts; for these rules seem to

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¹⁰⁴ See *Spokane & I. E. R. R. v. Spokane County*, *supra* note 80.

¹⁰⁵ See *People v. Illinois Central R. R.*, 273 Ill. 220, 112 N. E. 700 (1916).

¹⁰⁶ See *Nevada-California Power Co. v. Hamilton*, 240 Fed. 485 (D. Nev. 1917), *aff'd.*, *Franklin v. Nevada-California Power Co.*, 264 Fed. 643 (C. C. A. 9th, 1920).

grow naturally out of the system. It is, in truth, doubtful in many cases whether even assessors themselves could adduce those vital facts, since they "express an intuition of experience which outruns analysis and sums up many unnamed and tangled impressions." This is "blind justice" in a new guise. In the long run it must be quite as damaging to the state as to private corporations. The state may, in the end, by a balancing of the results of guesses, get all the revenue it might otherwise have got; but this is no adequate compensation for the long series of mistakes, the expense, the delays, the disgruntlement incident to accomplishment of that result. It does make a vast difference how the result is accomplished. All parties stand to gain by a system that functions in the daylight.

V

The sort of system that is wanted need not be fashioned anew; a ready tax instrument seems to be at hand. The states in whose interest it is to be wielded have, moreover, the benefit of the example of its use in other states and the wisdom to be gleaned from their experience with it.¹⁰⁷ The use of gross earnings to measure corporate tax contributions is not a new tax invention; it bears the prestige of long and persistent recommendation by reputable fiscal engineers.¹⁰⁸ What are the virtues that commend it as a method better fitted for a place in our tax institutions

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¹⁰⁷ That property be a tax subject and that it be assessed according to value are constitutional compulsions in many states. Thus the use of gross earnings may require constitutional change, which may take different forms. Both of the above mentioned compulsions might be abolished, or property might be retained as a formal tax subject, the amount of the tax on which is to be measured by gross earnings. The latter has been the practice in Minnesota and California (see MINN. CONST. art. 4, § 32a, art. 9, § 1; *State v. Wells Fargo & Co.* *infra* note 109, at 454, 179 N. W. at 222; CAL. CONST., art. 13, § 14; and cases cited *infra* note 109) and is usually what is meant by "the gross earnings method." Since for assessment purposes either change operates much the same and with equal benefit, either one is urged as a substitute for present *ad valorem* methods.

¹⁰⁸ Seligman, in a comprehensive discussion of the faults and virtues of various methods, *op. cit. supra* note 1, 238-260, concludes, at p. 259, that while a tax on net earnings would be theoretically the best, "As a matter of practical wisdom it may be conceded that in not a few of the American states simplicity and convenience of administration are preferable to more ideal but more difficult methods. In such states the taxation of gross earnings may be recommended as an easy solution of the problem for the time being." See also Holcomb, NAT. TAX ASS'N. PROCEEDINGS (1912) 193 *et seq.*, 205 *et seq.*; Holcomb, *The Assessment of Public Service Corporations*, NAT. TAX ASS'N. PROCEEDINGS (1911) 149, 161; Foote, *Relation of Franchise Taxation to Service Rates*, NAT. TAX ASS'N. PROCEEDINGS (1907) 655; Shortt, *The Taxation of Public Service Corporations*, *ibid.* 622; Plehn, *Taxation of Public Service Corporations*, *ibid.* 635.

than those presently in use?

In addition to the virtues that courts who have dealt with the method have found in it—simplicity, convenience, inexpensiveness, less litigation¹⁰⁹—should be noted another that is a sort of synthesis of the rest—controllability. It results from the elimination of some of the unknowns and variables from the assessment process. Of the several things that one would assume to be causes of change in the amount a public utility is asked to contribute to state revenues, the most obvious and important is the tax rate. If our existing tax institutions were less unruly in their workings, we could expect the amount to be a matter firmly controlled by our legislatures, for it would respond mainly to a change in the tax rate. We should, of course, expect change to result from changes in properties, and from variations in the pace of business activity; but we should look for simpler and more predictable change: more property, more taxes, roughly in proportion to the increase in property; less property, less taxes; prosperity, higher valuation, more taxes; depression, lower valuation, less taxes. Unfortunately, our mechanisms do not function so neatly. The whole assessment process becomes another variable. Even if the above factors remained constant (as in some instances for limited periods they have) the result would probably vary unless assessors were content to adopt previous assessments as their own. What does it avail a legislature that it controls the rate if its wishes are set at naught by the vagaries of the assessment process? The task of fashioning a tax policy and the machinery to carry it into effect is the legislature's. The answer to the question "How much?" (which is really the company's chief interest, since to them it is only of secondary interest how the sum was arrived at) is supposed to lie with the legislature. Here is the crux of the whole matter. What is wanted is machinery that will obey the will of its supposed masters and reach a desired goal as they direct. The present system is more like a rudderless ship. The gross earnings method makes the rate more truly an instrument of control. It offers freedom from conditions in which the causes of changing tax bases must remain buried in the inmost crypts of assessors' psyche, and in which the judiciary and their servants must perform prodigies of numerical jugglery to show that the assessors were either right or wrong.

A proposed substitute is not to be condemned because it brings no promise of freedom from all the problems and defects of its predecessor. Ups and downs in business would perhaps be reflected in assessments by the gross earnings method more closely

¹⁰⁹ See *State v. Wells Fargo & Co.*, 146 Minn. 444, 179 N. W. 221 (1920); *State v. Great Northern Ry.*, 174 Minn. 3, 10, 218 N. W. 167, 169; *cf.* *Pacific Gas & Electric Co. v. Roberts*, 168 Cal. 420, 143 Pac. 700 (1914).

and directly than before. The effects of this undoubted tendency could be mitigated by using an average of gross earnings over a period of, say, five years. The resulting sum would then reflect a trend in earnings rather than immediate slumps or spurts. Although the tax base would change from year to year, the fluctuation would follow some intelligible and observable cause; and certainly many would feel that there is a large measure of justice in a base that followed the trend of earnings. Nor is the chronicle of the gross earnings method barren of law suits. Problems of jurisdiction, apportionment, interference with interstate commerce, and others remain. But it is enough that it greatly simplifies the process of arriving at a tax base and that its peculiar problems are comparatively fewer and simpler.

Ultimately, something more is to be hoped for than a piecemeal patching of our tax institutions. Our property taxes have been found wanting. If a change in tax institutions is to be effected it must be preceded by a change in prevailing ways of thinking about taxes. A few minds have begun to blaze the way. One judge unwittingly helped when with some apprehension he remarked that "It may become of vital importance at some time to inquire whether a tax levied upon a capitalization of a profit is not a tax upon a profit."¹¹⁰ What does it mean to say that a tax is "on" a given subject? What does it mean to tax property? Mr. Justice Holmes has given us his answer. "Taxes generally are imposed upon persons, for the general advantages of living within the jurisdiction, not upon property, although measured more or less by reference to the riches of the person taxed . . ."¹¹¹ "Since the commercial value of property consists in the expectation of income from it, and since taxes ultimately, at least in the long run, come out of income, obviously taxes called taxes on property, and those called taxes on income or receipts, tend to run into each other . . ."¹¹² The truth of the last statement is strongly attested by the workings of the present system, and more particularly by the predominance of the capitalization of earnings method. Another authority pointedly says, "If . . . the *ad valorem* method necessarily means in practice the indirect use of the earnings method, the question arises: why not use directly what you are compelled to use indirectly. We may go further and affirm that nothing is gained, but much is lost, by electing the indirect, rather than the direct, earnings

¹¹⁰ *Standard Oil Co. v. Howe*, 257 Fed. 481, 488 (C. C. A. 9th, 1919); cf. *Opinion of the Justices*, 220 Mass. 613, 108 N. E. 570 (1915).

¹¹¹ *Dissent in Safe Deposit & Trust Co. v. Virginia*, 280 U. S. 83, 97, 50 Sup. Ct. 59, 62. (1929).

¹¹² *Galveston, Harrisburg & San Antonio R. R. v. Texas*, 210 U. S. 217, 226, 28 Sup. Ct. 638, 639 (1908).

method.”¹¹³ This is, of course, merely substituting a better measuring tool for a worse. But with it may come a realization that most taxes, at least property taxes, are ultimately “on” income.

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¹¹³ Seligman, *op. cit. supra* note 1, at 257.