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INSURED BANKS

GOVERNMENT  
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DOCUMENTS

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HEARINGS

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BEFORE THE KANSAS STATE UNIVERSITY

COMMITTEE ON  
BANKING, HOUSING AND URBAN AFFAIRS  
UNITED STATES SENATE

NINETY-SECOND CONGRESS

SECOND SESSION

ON

S. 3652

A BILL TO CLARIFY AND REGULATE THE POWERS OF THE STATES TO TAX COMMERCIAL BANKS, TO EMPOWER THE STATES TO TAX NATIONAL BANKS, TO FOSTER AND PROMOTE THE DUAL BANKING SYSTEM BY PROVIDING FOR EQUAL STATE TAXATION OF NATIONAL AND STATE BANKS, TO PROMOTE THE INTERSTATE FLOW OF MONEYED CAPITAL AND THE FINANCIAL RESOURCES OF INSURED BANKS, TO FOSTER AND PROMOTE INTERSTATE AND FOREIGN COMMERCE, AND FOR OTHER PURPOSES

AUGUST 1 AND 2, 1972

Printed for the use of the  
Committee on Banking, Housing and Urban Affairs



U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1972

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## STATE AND LOCAL TAXATION OF INSURED BANKS

TUESDAY, AUGUST 1, 1972

U.S. SENATE,  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 10:09 a.m., pursuant to call, in room 5302, New Senate Office Building, Senator John Sparkman, chairman of the committee, presiding.

Present: Senators Sparkman, Proxmire, Tower, Packwood, and Brock.

The CHAIRMAN. Let the committee come to order, please.

We are starting today on 2 days of hearings on the question of State taxation of insured banks.

The committee has before it S. 3652, a bill to clarify and regulate the powers of the States to tax commercial banks, to empower the States to tax national banks, to foster and promote the dual banking system by providing for equal State taxation of national and State banks, to promote the interstate flow of moneyed capital and financial resources of insured banks, to foster and promote interstate and foreign commerce and for other purposes.

The committee also has before it an amendment offered to this bill by Senator Proxmire relating to the honoring by any insured bank or institution of checks drawn upon the Treasury of the United States.

The Proxmire amendment would also provide for 100 percent deposit insurance for funds of public bodies placed in insured banks and institutions.

S. 3652 would take the place of the present arrangement regarding State taxation of national banks provided by Public Law 91-156 which expires December 31 of this year.

Also, the so-called permanent amendment providing the Public Law 91-156 which takes effect on January 1, 1973.

The House Banking and Currency Committee has pending before it a similar bill, H.R. 15656. This bill has been reported to the full committee by the Subcommittee on Bank Supervision and Insurance.

We will receive testimony on both bills.

(Reprints of the bill and the amendments follow :)

92<sup>D</sup> CONGRESS  
2<sup>D</sup> SESSION

# S. 3652

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IN THE SENATE OF THE UNITED STATES

MAY 30, 1972

Mr. BENNETT (by request) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing and Urban Affairs

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## A BILL

To clarify and regulate the powers of the States to tax commercial banks, to empower the States to tax national banks, to foster and promote the dual banking system by providing for equal State taxation of national and State banks, to promote the interstate flow of moneyed capital and the financial resources of insured banks, to foster and promote interstate and foreign commerce, and for other purposes.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3       SECTION 1. The Federal Deposit Insurance Act (12  
4       U.S.C. 1811-1831) is amended by adding the following  
5       new section after section 23 thereof (12 U.S.C. 1831):

6       “SEC. 24. STATE TAXATION OF INSURED BANKS.—

7       “(a) AUTHORIZATION FOR STATES TO TAX NATIONAL

1 BANKS.—For the purposes of any tax imposed under the  
2 authority of the United States or any State, a national bank  
3 shall be treated as a bank organized and existing under the  
4 laws of the State or other jurisdiction within which its prin-  
5 cipal office is located.

6 “(b) TAXATION BY JURISDICTIONS WHERE BANKING  
7 OFFICES ARE LOCATED.—

8 “(1) EXISTING TAXES.—A State or a political sub-  
9 division thereof may impose upon all insured banks having  
10 banking offices within its boundaries, subject to the restric-  
11 tions and limitations set forth in subsection (d) of this sec-  
12 tion, any taxes imposed on any insured banks at the date of  
13 enactment of this section: *Provided, however,* That this au-  
14 thorization to continue existing taxes on insured banks does  
15 not apply to taxes which are imposed in the same manner on  
16 insured banks and business corporations generally and which  
17 are imposed at a higher rate upon banks than upon other  
18 corporations.

19 “(2) FUTURE TAXES.—A State or political subdivision  
20 thereof may impose upon an insured bank having a banking  
21 office within its boundaries, subject to the restrictions and  
22 limitations set forth in subsection (d) of this section, any  
23 taxes imposed by legislation enacted after the date of enact-  
24 ment of this section which are imposed on business corpora-  
25 tions generally, and which are imposed throughout the

1 any other class of insured banks, or against insured banks  
2 as compared with mercantile, manufacturing, and business  
3 corporations doing business within such State or political  
4 subdivision, or against insured banks as compared with other  
5 moneyed capital and other financial institutions coming into  
6 competition with insured banks in such State or political  
7 subdivision.

8 “(3) If an insured bank maintains a banking office in  
9 more than one State or political subdivision, then each sepa-  
10 rate taxing jurisdiction may impose taxes on those banking  
11 offices located within its boundaries (and only on such bank-  
12 ing offices) as if such banking offices constituted a separate  
13 bank located within its jurisdiction. Nothing in this section  
14 shall be construed to prevent taxation of foreign income de-  
15 rived from sources outside the United States or its posses-  
16 sions, but such income may be taxed only to the banking  
17 office in which the income is actually received or accrued.

18 “(e) DEFINITIONS.—For the purposes of this section:

19 “(1) ‘Insured bank’ means any institution organized  
20 under the laws of the United States, any State of the United  
21 States, the District of Columbia, the Commonwealth of  
22 Puerto Rico, the Virgin Islands, Guam, or American  
23 Samoa—

24 “(i) which accepts deposits that the depositor has  
25 a legal right to withdraw on demand, and

1           “(ii) which engages in the business of making com-  
2       mercial loans, and

3           “(iii) deposits in which are insured by the Federal  
4       Deposit Insurance Corporation.

5           “(2) ‘Banking office’ means any office which is author-  
6       ized to accept demand deposits and make commercial loans  
7       in the ordinary course of its trade or business.

8           “(3) ‘Intangible personal property’ includes, but is  
9       not limited to, mortgages, bonds, notes and other obliga-  
10      tions, shares of stock, warrants, currency, coins, checks, credit  
11      cards, credit card accounts, funds on deposit at Federal Re-  
12      serve banks, other banks or elsewhere, and contracts, accounts  
13      receivable, judgments, and other similar documentary or  
14      other evidence of claims on others.

15          “(4) ‘State’ means any of the several States of the  
16      United States, the District of Columbia, the Commonwealth  
17      of Puerto Rico, the Virgin Islands, Guam, American Samoa,  
18      and any other taxing authority operating pursuant to the  
19      authority of the Congress of the United States.

20          “(5) ‘Rate’ means the actual percentage figure or dollar  
21      amount applied to the tax base.”

22      SEC. 2. Revised Statutes, section 5219 (12 U.S.C. 548)  
23      and the amendments thereto made by Public Law 91-156  
24      and by Public Law 92-213 are repealed.

92<sup>D</sup> CONGRESS  
2<sup>D</sup> SESSION

# S. 3652

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IN THE SENATE OF THE UNITED STATES

JULY 26, 1972

Referred to the Committee on Banking, Housing and Urban Affairs and ordered  
to be printed

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## AMENDMENT

Intended to be proposed by Mr. PROXMIRE to S. 3652, a bill to clarify and regulate the powers of the States to tax commercial banks, to empower the States to tax national banks, to foster and promote the dual banking system by providing for equal State taxation of National and State banks, to promote the interstate flow of moneyed capital and the financial resources of insured banks, to foster and promote interstate and foreign commerce, and for other purposes, viz: On page 6, line 24, insert the following:

1 TITLE II—HONORING CHECKS DRAWN UPON THE  
2 TREASURY OF THE UNITED STATES

3 CHECK CASHING

4 SEC. 101. No insured bank or insured institution shall—

5 (1) refuse to honor any check drawn upon the

6 Treasury of the United States upon presentation of such

**Amdt. No. 1364**

1 check by the payee, together with adequate identifica-  
2 tion, on the ground that such payee does not maintain  
3 an account with such bank or institution; or

4 (2) make any charge to such payee for the honor-  
5 ing of such check.

6 REGULATIONS

7 SEC. 102. The Secretary of the Treasury shall prescribe  
8 regulations necessary or appropriate to effectuate this title  
9 prior to the ninetieth day after the date of its enactment.

10 DEFINITIONS

11 SEC. 103. For the purposes of this title, the term—

12 (1) “Insured bank” shall have the same meaning as is  
13 applied to such term in section 3 (h) of the Federal Deposit  
14 Insurance Act (12 U.S.C. 1813 (h)).

15 (2) “Insured institution” shall have the same meaning  
16 as is applied to such term in section 401 (a) of the National  
17 Housing Act (12 U.S.C. 1724 (a)).

18 EFFECTIVE DATE

19 SEC. 104. The provisions of this title shall take effect  
20 upon the date of its enactment, except that section 101 shall  
21 take effect on the ninetieth day after the date of its enact-  
22 ment.

1 TITLE III—FULL DEPOSIT INSURANCE FOR  
2 PUBLIC UNITS

3 FULL DEPOSIT INSURANCE FOR PUBLIC UNITS

4 SEC. 201. (a) The Federal Deposit Insurance Act is  
5 amended—

6 (1) in subsection (m) of section 3 (12 U.S.C.  
7 1813 (m) ), by inserting immediately after “depositor”  
8 in the first sentence the following: “(other than a  
9 depositor referred to in the third sentence of this sub-  
10 section)”;

11 (2) in subsection (i) of section 7 (12 U.S.C.  
12 1817 (i) ), by striking out “Trust” and inserting in lieu  
13 thereof the following: “Except with respect to trust funds  
14 which are owned by a depositor referred to in paragraph  
15 (2) of section 11 (a) of this Act, trust”; and

16 (3) in subsection (a) of section 11 (12 U.S.C.  
17 1821 (a) ), by inserting “(1)” immediately after “(a)”,  
18 by striking out “The” in the last sentence and inserting  
19 in lieu thereof the following: “Except as provided in  
20 paragraph (2), the”, and by inserting at the end of such  
21 subsection the following:

22 “(2) (A) Notwithstanding any limitation in this Act or

1 in any other provision of law relating to the amount of deposit  
2 insurance available for the account of any one depositor, in  
3 the case of a depositor who is—

4 “(i) an officer, employee, or agent of the United  
5 States having official custody of public funds and law-  
6 fully investing the same in an insured bank;

7 “(ii) an officer, employee, or agent of any State  
8 of the United States, or of any county, municipality, or  
9 political subdivision thereof having official custody of  
10 public funds and lawfully investing the same in an in-  
11 sured bank in such State;

12 “(iii) an officer, employee, or agent of the District  
13 of Columbia having official custody of public funds and  
14 lawfully investing the same in an insured bank in the  
15 District of Columbia; or

16 “(iv) an officer, employee, or agent of the Com-  
17 monwealth of Puerto Rico, of the Virgin Islands, of  
18 American Samoa, or of Guam, or of any county, mu-  
19 nicipality, or political subdivision thereof having official  
20 custody of public funds and lawfully investing the same  
21 in an insured bank in the Commonwealth of Puerto  
22 Rico, the Virgin Islands, American Samoa, or Guam,  
23 respectively;

24 his deposit shall be insured for the full aggregate amount of  
25 such deposit.

1       “(B) The Corporation may limit the aggregate amount  
2 of funds that may be deposited in any insured bank by any  
3 depositor referred to in subparagraph (A) of this paragraph  
4 on the basis of the size of any such bank in terms of its  
5 assets.”

6       (b) Title IV of the National Housing Act is amended—  
7       (1) in section 401 (b) (12 U.S.C. 1724 (b) ), by  
8       striking out “Funds” in the third sentence and insert-  
9       ing in lieu thereof the following: “Except in the case  
10       of an insured member referred to in the preceding sen-  
11       tence, funds”;

12       (2) in section 405 (a) (12 U.S.C. 1728 (a) ), by  
13       inserting after “except that no member or investor” the  
14       following: “(other than a member or investor referred  
15       to in subsection (d) ) ”; and

16       (3) by adding at the end of section 405 (12 U.S.C.  
17       1728), the following new subsection:

18       “(d) (1) Notwithstanding any limitation in this sub-  
19       chapter or in any other provision of law relating to the  
20       amount of deposit insurance available for any one account,  
21       in the case of an insured member who is—

22       “(i) an officer, employee, or agent of the United  
23       States having official custody of public funds and law-  
24       fully investing the same in an insured institution;

25       “(ii) an officer, employee, or agent of any State

1 of the United States, or of any county, municipality,  
2 or political subdivision thereof having official custody  
3 of public funds and lawfully investing the same in an  
4 insured institution in such State;

5 “(iii) an officer, employee, or agent of the District  
6 of Columbia having official custody of public funds and  
7 lawfully investing the same in an insured institution in  
8 the District of Columbia; or

9 “(iv) an officer, employee, or agent of the Com-  
10 monwealth of Puerto Rico, or of the Virgin Islands, or  
11 of any county, municipality, or political subdivision  
12 thereof having official custody of public funds and law-  
13 fully investing the same in an insured institution in the  
14 Commonwealth of Puerto Rico or the Virgin Islands,  
15 respectively;

16 the account of such insured member shall be insured for the  
17 full aggregate amount of such account.

18 “(2) The Corporation may limit the aggregate amount  
19 of funds that may be invested in any insured institution by  
20 any insured member referred to in paragraph (1) of this  
21 subsection on the basis of the size of any such institution  
22 in terms of its assets.”.

**S. 3652**


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IN THE SENATE OF THE UNITED STATES

JULY 31, 1972

Referred to the Committee on Banking, Housing and Urban Affairs and ordered  
to be printed

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**AMENDMENT**

Intended to be proposed by Mr. TOWER (for himself and Mr. CRANSTON) (by request) to S. 3652, a bill to clarify and regulate the powers of the States to tax commercial banks, to empower the States to tax national banks, to foster and promote the dual banking system by providing for equal State taxation of National and State banks, to promote the interstate flow of moneyed capital and the financial resources of insured banks, to foster and promote interstate and foreign commerce, and for other purposes, viz: On page 6, line 24, insert the following:

- 1                   **TITLE II—THIRD-PARTY LOANS**
- 2                                   **THIRD-PARTY LOANS**
- 3           SEC. 101. Section 408 (d) (4) of the National Housing
- 4 Act is amended by—

**Amdt. No. 1383**

1           (1) striking out "a wholly owned" and inserting  
2 in lieu thereof "an";

3           (2) inserting immediately after "affiliate service  
4 corporation" the following: "wholly owned by one or  
5 more insured institutions"; and

6           (3) striking out ", and would not be a means of  
7 facilitating the sale of (1) property purchased from any  
8 savings and loan holding company or any affiliate there-  
9 of other than such service corporation, or (2) property  
10 heretofore owned, legally or beneficially, by any savings  
11 and loan holding company or affiliate thereof."

The CHAIRMAN. Our first witness today is Hon. George Mitchell, Board of Governors, Federal Reserve System.

We are very glad to have you with us.

May I say to all of the witnesses, all of the prepared statements will be printed in the hearings in full. You may present them if you please, read them, discuss them, or summarize them. I will leave it up to you.

We welcome you this morning.

**STATEMENT OF GEORGE W. MITCHELL, BOARD OF GOVERNORS,  
FEDERAL RESERVE SYSTEM, ACCOMPANIED BY ISRAEL M.  
LABOVITZ**

Mr. MITCHELL. Thank you, Mr. Chairman.

My plan was not to read my statement this morning but to comment on four salient points in the statement. However, I am perfectly prepared to read the statement if you would like me to do so. My preference is not to read it.

The CHAIRMAN. Very well.

(Mr. Mitchell's full prepared statement may be found at p. 34.)

Mr. MITCHELL. I have with me Mr. Labovitz who is the staff director of the tax study which the Board made at the direction of the Congress.

In my statement are four major issues which I think merit discussion. The first has to do with the taxation of intangibles owned by banks and the Board's recommendation that taxation of these intangibles should be prohibited.

The second has to do with the authority to allocate the bank tax base among the States and the Board's recommendation that the granting of this authority should be deferred until an allocation technique has been devised.

The third point has to do with discriminatory forms of taxation among banks and between banks and other institutions and how the Congress ought to deal with that problem.

And the fourth issue I would like to mention rather briefly has to do with insurance of public deposits.

Now let me turn first to the question of the taxation of intangibles.

The Board recommends that the Congress make permanent the present denial of the authority of the States and their political subdivisions to tax intangibles owned by national banks and to extend that denial to such property owned by State banks, savings and loan associations, mutual savings banks, and credit unions.

Now, this recommendation affects taxable bonds, and securities such as corporate bonds, notes, and mortgages. But it does not concern the taxation of bank shares or deposits or capital stock.

The major reason for this recommendation is that intangible taxes have failed to produce significant revenue for the States.

Our staff report estimated that the revenue produced for such taxes amounted to less than one-third of 1 percent of total State and local taxes.

Such taxes have created inequities in the administration and they simply have not worked.

As Dick Netzer said, the movement away from taxation of intangibles has been a surrender to reality.

Now, the evidence of this fact is that the majority of the States have given up explicitly—some by constitutional amendment—or implicitly all efforts to tax intangibles on that basis.

This trend essentially began with one of the more progressive States in the Union in tax matters, Wisconsin, and it began in 1912 when Wisconsin enacted its first income tax, the first modern income tax adopted by any State. And when that income tax was adopted Wisconsin foreswore the taxation of intangibles on an ad valorem basis and taxed them under the income tax.

Well, about 4 or 5 years later the State of New York followed suit and since that time States have gradually been moving away from ad valorem taxation of intangibles to income taxation of intangibles.

In my opinion today there wouldn't be any ad valorem taxation of intangibles if all States had income taxes. There are still some major States that do not have income taxes and, therefore, they are clinging to some form of ad valorem taxation.

The first point I would make is that the ad valorem taxation of intangibles is simply unworkable. It has been shown to be unworkable and something in the neighborhood of two-thirds of the States today do not use it.

Now, a second reason for banning the taxation of intangibles has to do with the multiple taxation that arises out of the nature of the intermediation process.

Let me just consider a simple example of an investment in an apartment building. Obviously this apartment building will be assessed as real estate and it will pay a tax of 1 to 3 percent of its fair value depending upon its location.

If there is a mortgage on this apartment building under the general property tax the mortgage is also taxable and it would be taxable at the same rate, something between 1 and 3 percent.

If the owner of the mortgage is a private investor then, in effect, this piece of income-producing property has to pay two taxes; one on the real property, one on the amount of the mortgage owned by the private investor.

But let's suppose that the private investor chooses to put his money in a bank or a savings and loan association. Then the bank or the savings and loan association buys a mortgage and the private investor has as an asset, a deposit in the bank or in the savings and loan association.

Under the general property tax law the property is taxed, the mortgage is taxed now to the bank or the savings and loan association and the deposit is taxed to the depositor. So there are three taxes involved here.

Obviously a system like this cannot work; and it has not worked because the burden on that particular property is more than the property can bear.

So States have moved to other methods of taxing intangibles such as the income tax or they have adopted low rates on mortgages and on bank deposits which people feel they can afford to pay or they have simply given up and in their tax administration they have not enforced their own laws.

Now, intermediation is an extremely valuable service to small savers. The great advantage of intermediation is that the saver has instant liquidity, that is, access to his savings, if they are in a bank or savings and loan association.

If he owns a mortgage he has the problem of selling the mortgage or disposing of it if he needs the cash.

If he has a passbook account in a bank or savings and loan association, he can draw his funds out whenever he needs it.

So this arrangement is a great advantage to small savers in this country.

I don't believe that a tax system ought to in any way discourage or impair this advantage and actually need not impair it in any way because there is another method of taxing the interests involved here and that is the income tax.

Now, there are other reasons that are advanced in my statement for supporting the Board's recommendation that intangibles not be taxed under the property tax.

I will not repeat them here. They are available and these two seem to me to be the most important reasons.

Now let me turn to the second issue. This has to do with the problem of allocating the bank tax base.

In the Board's original report it recommended that allocation be adopted and that each State be permitted to tax banks that do business in the State, regardless of where their home office is.

But the problem with this recommendation is that we do not have a method of allocating the base of taxation among the States and a method needs to be developed and needs to be endorsed by the States generally before that recommendation can be properly implemented.

The present formula used for business corporations to allocate the tax base among the States is a three-part formula consisting of payrolls, property and sales.

Now, if you applied a formula of this sort to banks the payrolls would be almost exclusively in the domiciliary State, the State where the main office is; and all the property, virtually all the property—there are a few minor exceptions—would also be in the domiciliary State.

It is difficult to say what a sale is in the case of a bank or a savings and loan association.

Is an investment a sale or is a loan a sale or is a deposit a sale?

No theory has been developed to deal with this problem. There is no practical application that has been developed. And at the present time we simply don't know how to interpret a sales component of an allocation formula.

Until we have an appropriate allocation formula, the Board's recommendation is that we use domiciliary taxation for banks.

The Board believes that the responsibility for devising a formula should be given to the Treasury or to the Committee on Intergovernmental Relations for the reason that both of these agencies have the background and the expertise but most important of all they have the consultative channels to deal with State taxing authorities.

The Board does not have these qualifications and for that reason it does not believe that it ought to have the responsibility for pursuing this matter.

Now, thirdly, I want to say something about the problem of discriminatory taxation.

The courts and the Constitution have been primary defenses of taxpayers against discriminatory taxation and Senate bill 3652 has a good bit of language in it which endeavors to add to the protection against discriminatory treatment. But our view is that this new language is likely to cause more damage to established precedents than it is to strengthen and to clarify the kinds of discrimination that ought to be prohibited.

So the Board's view has been that essentially new language on discriminatory taxation is not really needed in the statute.

The problem of discrimination is extremely difficult. There is a large section of the report trying to analyze how to measure discrimination between banks and other financial enterprises and other nonfinancial enterprises and it really comes to the conclusion that it can't be done.

You can do something about prohibiting and regulating discrimination among different kinds of banks, between State and national banks, for example. You can have uniform treatment for State and national banks. You can have uniform treatment for member and non-member banks. You can have uniform treatment for banks domiciled in the State and banks domiciled outside of the State. Although I am not necessarily recommending it, you could have uniform treatment among banks and savings and loan associations, credit unions, mutual savings banks, because they are more or less similar institutions.

But trying to achieve uniform treatment between financial institutions of a depository character, and nonfinancial institutions is virtually an insolvable problem, although unreasonable discrimination should, of course, be avoided.

That is the reason essentially for our recommendations with respect to discriminatory taxation.

Finally let me say a few words about the insurance of public deposits.

The Board holds to the view that it has expressed on several previous occasions that it would be unwise to provide 100-percent insurance for public deposits, primarily because it thinks that this action would have a damaging effect on the Government securities market.

As of right now the Treasury marketable debt amounts to about \$260 billion and of that \$260 billion about \$170 billion is in the hands of the public, including the banks, of course.

Banks hold \$60 billion out of the \$170 billion.

Banks also hold a very large amount of municipal securities, over \$80 billion, in fact. They hold more municipals than they hold in Treasury obligations. And they hold about \$10 billion in Federal agency securities.

So their total holdings of Government securities that can be used for pledging purposes amount to something on the order of \$150 billion to \$160 billion and at the present time they need about \$70 billion for that purpose.

So under present-day conditions they have an adequate supply of securities for pledging purposes but as you well know, if loan demand picks up and the economy begins to roll more rapidly, credit demands will rise, banks will sell their Government securities, they will sell

their municipal securities. Their holdings of these securities will then begin to shrink.

In those periods the pledging requirement is a significant inducement for banks to hold Government and municipal securities.

The Board, therefore, thinks that this is a major consideration that ought to be kept in mind in deciding whether or not to substitute insurance for pledging.

The Board also believes that if the principle of full insurance of public deposits were later extended to cover private deposits some incentives for good bank management could be significantly weakened.

Finally, the Board thinks that it is unwise to divert active and short time deposits from banks to savings and loan associations, as might result if title III were enacted.

Public deposits essentially—I am talking about State and local deposits now—are made up of funds needed for operating purposes, amounting now to around \$25 billion, and temporary overruns or surpluses. For example, a municipality may borrow for construction purposes and hold those funds until needed for construction. These temporary surpluses amount now to about \$17 billion. And they vary in duration from a few weeks to a few months, and even to 2 or 3 years in some cases.

We do not believe that public policy should encourage the investment of funds of this kind in long-term liquid assets such as mortgages.

On the other matters with which this statement is concerned, I have not made any comment, but I think I have touched upon the most controversial and most important issues.

I am prepared, however, to deal with questions about any part of the statement that I have submitted to you.

That is the end of my remarks, Mr. Chairman.

The CHAIRMAN. Well, thank you very much, Governor Mitchell. You have given a very fine discussion of a good many things.

When you speak of taxation of deposits, I think I know what it means, but when you were speaking it sounded like the deposit itself was taxed. Actually, the bank is taxed, and the deposits constitute one of the assets on which it is taxed; is that correct?

Mr. MITCHELL. Well, it depends upon the State in question. Generally, I think a tax of that kind is levied on the deposit and absorbed by the banks. There are not very many of them. I think this is the case in Indiana and Michigan.

Under a general property tax, however, you as a taxpayer in a general property tax State, are required to file a return showing all your tangible property and your intangible property including bank deposits, and you would pay directly.

The kind of bank deposit tax that some States have used, such as Indiana and Michigan, is a different type of deposit tax. It is levied on the depositor but absorbed by the bank.

The banks do not pass it on.

It is a relatively low-rate tax, very low rate.

The CHAIRMAN. I have a good many questions I want to propound. I shall hope to do it before we complete the 2 days of hearings in order that we can move right along.

I call on Senator Proxmire.

Senator PROXMIRE. In your statement you reprint seven articles listed in the Federal study for restricting the authority of the States to tax commercial banks. This section of the study also includes five arguments for giving States complete freedom to decide their own tax policies.

Is there some reason why your State picks up the seven arguments against State autonomy but ignores the five arguments for autonomy or is this an inadvertent oversight?

Mr. MITCHELL. I don't know about the ratio of 7 to 5.

Senator PROXMIRE. You gave us the 7 to 0 there.

Mr. MITCHELL. Yes.

I think the argument against depriving the States of the autonomy to tax intangibles is that it has not worked in most of the States.

The States are in the process of abandoning it and all States would have abandoned it—

Senator PROXMIRE. Well, you state the arguments in favor of depriving the States of this autonomy but you don't give us the counter-arguments. That is what I am asking.

Mr. MITCHELL. Well, you see, the counterargument—

Senator PROXMIRE. The way I look at it is the banks are big boys. They have been able to take care of themselves in the State legislatures for years. When I was in the State legislature—before then I was a reporter on the Madison, Wis., Capital Times. As you know, we had open public inspection of income tax returns in Wisconsin.

I took the income tax returns of the five biggest banks in the State of Wisconsin. First Wisconsin and so forth. Banks that had net incomes in the tens of millions of dollars a year in aggregate.

I took their income for 5 years, the five biggest banks. That added up to several hundred million dollars. Maybe a billion dollars.

Do you know what they paid in taxes altogether? The taxes they paid the State government during that 5-year period? \$73. \$73.

It was a disgrace.

And you know, for the Federal Reserve and the bank—and the American Bankers Association to come to the Congress and say we need protection, really stretches our credibility.

The banks, after all—let's face it, the banks have an unusual influence and they ought to have. They are fine people. They are articulate. They are certainly affluent. They know how to work their way around a State legislature. Let's not kid ourselves.

The notion that we have to rush this through to protect the banks from some kind of deprivation by greedy State legislatures who are going to overwhelm them doesn't impress me at all.

I would like to know in your statement why you omit the arguments you have in your study for giving the States this kind of free right to tax banks that they have to tax everyone else.

Mr. MITCHELL. Well, the kind of autonomy we think ought to be given the States is encompassed in the argument for allocation of the tax base among the States in which banks operate and as far as the amount of taxes that banks pay, which Wisconsin banks now under the income tax are paying \$7 million.

Senator PROXMIRE. They are doing better now, yes.

Mr. MITCHELL. In California, they are paying \$43 million and New York, they are paying \$90 million.

Senator PROXMIRE. You show they are not paying what they ought to pay.

You would not object then if I got a unanimous consent to insert in the record the five arguments which you say in your study on pages 53 and 54, favor giving the banks this free right to tax.

We have to be fair and I should say giving the States the right. Giving the States the rights they should have anyway in regard to the banks.

Do you think that would be all right, sir?

Mr. MITCHELL. Oh, certainly. The Board did—I am trying to recall this statement.

Senator PROXMIRE. You had it in your studies. You do not have it in your statement at all.

(The excerpt from the Federal Reserve study follows:)

[Reprint From the Federal Reserve Study]

Arguments for letting the "permanent amendment" take effect without change—that is, for allowing States the option of taxing intangible personal property of banks—may be summarized as follows:

(1) The Federal Government should refrain from imposing limits upon the authority of States to devise their individual tax systems as long as they conform to Federal constitutional requirements. Freedom to be different and to experiment is a valuable attribute of our system of dual sovereignty; this freedom should be safeguarded. The permanent amendment of section 5219 is of special importance symbolically in unshackling the States. Restoration of any part of the earlier limitations would be a step backward.

(2) Under the system of ad valorem taxation of property that is the major source of local government revenue in the United States, the value of the assets owned by individual enterprises generally is used as a base for measuring their obligations to contribute to the financing of local government. These assets are predominantly real and tangible personal property but in more than half of the States intangibles also are covered, either comprehensively or in selected classes. A characteristic of financial businesses, and especially of banking, is that the largest part of the assets of each firm consists of intangibles. Continued prohibition of the taxation of bank-owned intangibles would exclude these assets from the base that is used to measure the banks' obligations to pay taxes.

(3) Where an intangibles tax is used, it helps to insure that all owners of assets contribute to the cost of government. The taxable situs of intangibles may be in a different jurisdiction from the tangible property that underlies some of the intangibles. To what extent the underlying wealth is taxed is usually uncertain. Moreover, not all intangibles are representative of tangible personal or real property. In any event, ownership of the intangibles and ownership of the underlying physical assets (if any) are in different taxpayers. If a State elects to subject intangibles to taxation, the tax obligation of the creditor to his State should not be set aside because the debtor may also be paying taxes on the related tangible property. The creditor's State has a right to ask that the creditor help support the government from which it receives services; and if that State uses property values, including intangibles, as a measure of taxpayers' obligations, bank-owned assets may properly be part of the measure.

(4) From the point of view of the taxing authority, advantages of the intangibles tax as applied to banks are that the bulk of the assets are easily valued; there is little room for assessors to exercise cursory or uninformed judgment; and concealment is less likely than with other owners of this class of property.

(5) The property tax provides a comparatively stable base for taxation; in jurisdictions where intangible property is an element in this base, bank-owned intangibles would constitute a desirable component in view of their persistent growth.

Mr. MITCHELL. I can only say, Senator, that the conclusion of the Board was the public interest was not served by taxing intangibles in the States.

Senator PROXMIRE. Do you know of any other business which receives Federal protection from State taxation?

Mr. MITCHELL. Well, anyone that owns tax-exempt securities obviously receives some Federal protection.

Senator PROXMIRE. Yes; but that is free to anybody?

Mr. MITCHELL. That is not by business, it is by type of assets.

Senator PROXMIRE. As you pointed out—

Mr. MITCHELL. We recommend that advantage should not exist. It does not really exist if you call it a franchise tax and measure the franchise tax by income including income from tax-exempts.

Senator PROXMIRE. My question was, do you know of any other businesses which receive Federal protection from State taxation?

Mr. MITCHELL. Well, I do not know whether under the interstate commerce clause, there would be some businesses affected. I do not know, Senator.

Senator PROXMIRE. You argue that if States were free to impose a tax on intangibles this might impair the efficient functioning of the payment system. Are you saying the payment system would collapse or be destroyed because of State taxation of intangibles?

Mr. MITCHELL. No. I think the thing that would happen if a State determined it was going to tax intangibles, say at general property tax rates, is it would drive a lot of business out of that State and people would do their—

Senator PROXMIRE. Does that happen in Florida?

Mr. MITCHELL. That is a low rate, intangibles tax. The Florida tax—

Senator PROXMIRE. Would not every State have the same incentive? No State or State legislature you have ever heard of would want to drive the banks out of their State. They would be insane to do that. Any more than they wanted to drive other agencies or firms out of their State. States want business.

Mr. MITCHELL. Well, Senator, could I run through a few numbers for you?

Senator PROXMIRE. Sure.

Mr. MITCHELL. As I said earlier, States are moving away from ad valorem taxes on intangibles, and substituting income taxes. Let me give you some figures comparing the yields these States now receive on income taxes on banks, with the yields they would get if they applied an intangibles tax like the one in Florida.

In California, \$43 million, under the income tax. It would be \$32 million if you used the Florida system as near as we can tell.

In the case of Massachusetts, \$14.5 million from the income tax. Under the Florida system, \$7.5 million.

In Michigan, \$10 million under the income tax; it would be \$14 million under the Florida system. It would be somewhat higher under the Florida system.

In Minnesota, \$10.7 million, compared to \$6 million.

Missouri, \$9.5 million compared to \$8 million.

In New York, \$90 million compared to \$65 million.

Senator PROXMIRE. May I ask where you are getting your documentation? We asked the Federal Reserve for this, and they said they could not get it. We went to the Library of Congress and got a study from them.

Mr. MITCHELL. The numbers on income tax are in our report.

Senator PROXMIRE. What about the Florida tax?

Mr. MITCHELL. That I got this morning, the 1 percent Florida tax.

Senator PROXMIRE. I have a letter from you dated August 1, in which you said, you could not get it.

Mr. MITCHELL. You are going to have it in a day or two, I hope.

Senator PROXMIRE. We got it from the Library of Congress, all right.

Can the Federal Government constitutionally prohibit States from imposing taxes on its business if it regards the tax as unfair or inefficient? Where do we draw the line to single out banks for special protection?

Mr. MITCHELL. I cannot answer that question, Senator. I will supply an answer (see p. 26).

Senator PROXMIRE. I would appreciate that. It seems to me this is a precedent. I can imagine other businesses coming in saying they would like the same treatment.

Mr. MITCHELL. I think under the commerce clause, Congress might do something. This particular bank taxation is based upon the national bank—

Senator PROXMIRE. You see, I think it is important to show that because if you—concede the payment system is not going to collapse, and this is just a matter of the Federal Government regarding the intangible system as inefficient, it seems to me that is a weak basis on which to try to move into the Federal legislation, to deny the States the ability to raise the money they so desperately need, now.

Mr. MITCHELL. Well, I do not disagree with your philosophical basis. All I say is, using the intangibles technique is a snare and delusion.

It has been a failure wherever it has been used and still is a failure.

Senator PROXMIRE. Of course, the issue is who decides that.

Mr. MITCHELL. Well—

Senator PROXMIRE. If the States were given complete authority to tax banks the same as other firms do you think they can be trusted to be fair and equitable?

Mr. MITCHELL. Well, I think—now going back to the allocation issue that unless they have a uniform method of allocation, I do not think they would be fair. If they have a uniform method of allocation, yes, they could be fair.

Senator PROXMIRE. How about on intangibles?

Mr. MITCHELL. My judgment, Senator, is that the States will not go back to intangibles taxation. There will only be a very small number and they will diminish.

Senator PROXMIRE. Then why go to this extraordinary length of prohibiting it if they are not going to go back to it?

Why should we move in this way?

Mr. MITCHELL. We are not moving in to change anything. If we moved in the direction, the direction you are suggesting, we would be moving away from the position we have been in.

In other words, the policy has been to prohibit it.

Senator PROXMIRE. Well, we are moving to change in the sense, the prohibition expires the first of January, and you are requesting us to move to change that.

Mr. MITCHELL. But the history, you know, 40 to 60 years of history are in the other direction.

Senator PROXMIRE. In your prepared statement you say that one of the disadvantages of a tax on intangibles is it might give a certain savings in States where there is not an intangible. Are you suggesting, Mr. Mitchell, when you say that, that a State legislature might not be alert enough to perceive this disadvantage and take it into account?

Mr. MITCHELL. Well, take Illinois, the situation there. I think it is very illuminating. April 1 is tax date in Illinois. On April 1, about \$2 billion leaves the banks in Illinois.

It leaves it in two ways: (a) corporations invest their entire balance in a treasury bill, preferably an April 1 bill; and (b), they take their deposits out of Illinois banks and put them in banks outside of Illinois, and the banks outside of Illinois return deposits in the form of interbank deposits to Illinois.

Now, these are maneuvers that have even affected the Government securities market to the extent that the April 1 bill has had a negative yield because there is such a demand for those bills.

Now, this is a silly thing to have happen.

Senator PROXMIRE. I am familiar with the situation of Illinois and I agree that it does not make much sense to me.

But—

Mr. MITCHELL. Illinois has corrected it—

Senator PROXMIRE. They have, as you say, corrected it and if it is not wise to leave that to the State legislative process. We have heard a lot of talk about how the Federal Government tries to centralize everything in Washington and there is a great deal of wisdom in the States.

We ought to leave it to them. That is one of the principles, I take it, that motivates the Nixon administration, in their revenue-sharing efforts.

I feel the weakness of revenue sharing is that it divorces responsibility for raising money which is a discipline from the opportunity to spend that money and I think it is a very, very serious weakness; and to the extent we deprive the States of the opportunity to raise taxes and instead, substitute revenue-sharing system, I think we lose the discipline to hold spending down.

Mr. MITCHELL. I certainly subscribe to that general view. I think we should bear in mind that while these taxes are significant, as far as banks are concerned, as far as the revenues of State and local governments are concerned, they are relatively small. A third of 1 percent.

Senator PROXMIRE. I do not know if there is anything to that. Which version of the State taxation does the Federal Reserve prefer; S. 3652 or title I of—

Mr. MITCHELL. We do not think we prefer S. 3652.

Senator PROXMIRE. You prefer the House bill?

Mr. MITCHELL. Yes. That is right. In fact, our—

Senator PROXMIRE. My time is up. But, would you indicate the reasons for that?

Mr. MITCHELL. Yes, I will put it in a letter.

(The following was received for the record:)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
*Washington, D.C., August 3, 1972.*

HON. JOHN SPARKMAN,  
*Chairman, Committee on Banking, Housing and Urban Affairs,  
 U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: When I appeared before your Committee on Tuesday, I was asked to submit for the record answers to two questions.

First, I was asked about the authority of Congress under the Constitution to limit the power of the States to tax banks. I believe that this authority stems from the power to coin money and regulate the value thereof and the power to regulate interstate commerce. The question is discussed in some detail in the enclosed memorandum prepared by a former general counsel of the Board, David B. Hexter.

Second, I was asked why the Board recommends enactment of the tax provisions of H.R. 15656 rather than those of S. 3652. As I pointed out at the hearing, there are three broad issues involved in these provisions. On the two issues that I consider most important—taxation of intangibles and allocation of income to the domiciliary State—the two bills reach substantially the same result. On the third issue—discrimination—the Board prefers the more general provisions of H.R. 15656 because we believe S. 3652 reaches unfortunate and possibly unintended results, by dealing with this question too specifically. Let me illustrate the point with two examples.

Section 24(b)(2) of S. 3652 would prohibit States from imposing any tax on banks in the future unless the tax is "imposed on business corporations generally." Thus, if a State now imposes a tax on bank shares but wished in the future to substitute a franchise tax measured by gross income, applicable only to banks, it would be prohibited from doing so. This seems needlessly restrictive. Section 24(d)(2) seems to prohibit a State from imposing any tax that results in a higher overall tax burden on commercial banks than on mutual savings banks, savings and loan associations, or credit unions. Views may differ as to how the "overall tax burden" is to be measured, and I am not prepared to defend all of the present differences in treatment among these institutions. Nevertheless, if this provision were interpreted to require uniformity in taxation it would unnecessarily restrict the authority of the States to make reasonable distinctions, based on form of organization, functions, and other relevant factors.

Sincerely yours,

GEORGE W. MITCHELL.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
*March 17, 1971.<sup>1</sup>*

OFFICE CORRESPONDENCE

To: Mr. Labovitz.

From: D. B. Hexter.

Subject: Power of Congress to limit a State's taxation of its "own" commercial banks.

You are currently drafting a proposed Report and Recommendations on State Taxation of Banks, which is to be submitted to the Board for its consideration. Public Law 91-156 (approved December 24, 1969) requires the Board to study that subject and make a report thereon to Congress, including "recommendations as to what additional Federal legislation, if any, may be needed." You may decide to suggest a Board recommendation that Congress enact legislation restricting the power of a State to tax banks located therein (both national banks and State banks, whether FDIC-insured or not). You have asked for my opinion as to the authority of Congress to enact such legislation.

This question must be distinguished from other questions that would be less open to argument. For example, if a particular bank is engaged in out-of-State activities in such manner and to such extent as to be subject to taxation (e.g., income, excise, on intangible property taxes) in more than one State, it would not be seriously contended that Congress lacks authority to regulate State taxation of that bank. Likewise, it is hardly open to doubt that Congress possesses authority to restrict State taxation of all banks insured by the FDIC [use 12 U.S.C. 265].

<sup>1</sup> This memorandum was held in draft form over two months, awaiting the May 21, 1971 legislative recommendation mentioned in the next-to-last paragraph.

Since insured banks hold over 99 per cent of the commercial banking resources of the United States, you may wish to consider the advisability of narrowing this aspect of your recommendations to that slight extent—that is, covering only insured banks—in order to avoid the possibility of constitutional arguments in Congress against the enactment of such legislation, or constitutional litigation after its enactment. However, this memorandum is addressed to the problem in its maximum breadth, as you have presented it to me.

The question, therefore, is whether Congress may constitutionally limit the power of Iowa, for example, to impose an intangible property tax on an Iowa-chartered bank that is not insured by the FDIC, solicits and makes loans only in Iowa, and has no depositors or borrowers that are not domiciled in that State.

It is relevant to ascertain Congress' motives in imposing such limitation, if it were to do so. (Presumably the legislative history of the law would disclose the motives.) As I understand it, the reason for such a Federal law would be Congress' concern with the danger that, under § 5219 of the Revised Statutes (12 U.S.C. 548) as it will read beginning January 1, 1972, a State might impose on banks a tax (such as a tax on intangible personal property) that might impede the growth of the banking industry. Such a tax might be imposed solely on banks accepting demand deposits, or on all financial institutions (suitably defined), or on individuals and corporations—in the last case, it would bear especially heavily upon banks and other financial institutions, and might be enforced solely against them, because they are uniformly large holders of intangible property and the amount of their holdings is readily ascertained for tax purposes.

But why would Congress be seriously concerned about a State tax system that particularly burdened commercial banks? The only valid reason occurring to me is Congress' conviction that a strong, growing, and dynamic commercial banking system is so vital to the nation and its economy as to justify special protection from State action inimical to those characteristics of the banking system.

Essentially, this was the motive that led to enactment of the original R.S. 5219 a century ago. Congress considered a vigorous system of "national banking associations" to be important to the nation, from such standpoints as (1) the currency system—national bank notes, (2) financing the Civil War through the sale of Federal Government obligations to be used as collateral for national bank notes, (3) a uniformly regulated and supervised commercial banking system, to replace the prior "wildcat" State banks, and (4) fiscal agency services to the Federal Government (R.S. 5155; 12 U.S.C. 90). The National Bank Act provided for a system that would serve the country in these ways, and since the U.S. Supreme Court had held in 1819 that "the power to tax involves the power to destroy" (*McCulloch v. Maryland*, 4 Wheat, 316, 431), R.S. 5219 was enacted to permit limited State taxation of national banks but to prevent the system from being weakened or destroyed by excessive State taxation.

All but the second of these reasons are valid and applicable today, *mutatis mutandis*, with respect to both elements (national and State banks) of the country's banking system. Transfer of funds through the banking system (mainly via checks) is now the principal mode of money transfer—far more important than currency transfer.<sup>2</sup> The commercial banking system is even more essential to the national economy than in 1864 or 1873. The fiscal agency functions of the banking system are more important than ever before. In addition, banks are a major link in the Federal government's efforts to regulate the economy through the implementation of monetary policy. (The matters referred to in the last two sentences, it must be conceded, relate to insured banks and member banks, respectively, rather than to all commercial banks, and consequently they are not strongly persuasive in this connection.)

On this approach alone, it could be plausibly argued that (1) all units of the commercial banking system are elements of *interstate commerce* (see cases cited hereinafter), (2) that said system is the institutional structure that holds and transfers most of the "money" of the United States, and (3) that it is an *instrumentality of the Federal government* that may validly be protected by Congressional action limiting State taxation.

*Plenary power of Federal government with respect to commercial banking system of the United States.*—Our question, as stated at the beginning of this memorandum, may be approached, with at least equal validity, from a different standpoint.

<sup>2</sup> Federal Reserve System, Purposes and Functions (5th ed., 1967 revision) 6-8.

In 1932, the Federal Reserve Board was asked by the Senate Banking Committee to suggest a constitutional method of creating a unified banking system in the United States. In accord with this request, the Board's General Counsel (Walter Wyatt) prepared an opinion, published in 1933 Federal Reserve Bulletin 166, in which he concluded that

"The enactment of [Federal] legislation restricting the conduct of the commercial banking business to national banks . . . would be not only constitutional but also entirely appropriate and in accordance with a division of authority between the Federal Government and the States."

That conclusion rested on three recognized powers of Congress, which were described at some length and related to the legislative proposal in question. These were:

"I. The power to create and maintain a banking system."

"II. The power to provide a national currency."

"III. The power to regulate and protect interstate commerce."

The conclusion reached in the opinion published in 1933 was reexamined on several occasions. In a 27-page memorandum dated December 19, 1936 (Legal Division File 400GG), Mr. Hackley summarized the three arguments in support of the constitutionality of legislation providing a unified commercial banking system, and reexamined the 1933 opinion in the light of subsequent Supreme Court decisions with respect to the powers of Congress. He expressed the opinion that "certain recent Supreme Court decisions definitely appear to strengthen . . . the arguments set forth in the [1933] opinion", although he stated that recent Supreme Court decisions "possibly . . . indicate a tendency to give the commerce clause a strict construction and to protect the powers of the States against increasing encroachments by the Federal government."

Mr. Hackley later wrote a 30-page memorandum on "Constitutionality of Legislation Providing a Unified Commercial Banking System in the Light of Supreme Court Decisions since 1932" (January 18, 1941; Records File 400.02). The general purport of his conclusions was that the trend of Supreme Court decisions indicated strengthened judicial support for the power of Congress to take such action. He pointed out that "The strict interpretation of the commerce clause taken by the Supreme Court in 1935 and in 1936 has been completely superseded by a more liberal interpretation \* \* \*." His final conclusion stated:

"The fact that every commercial bank is intimately and directly connected with interstate commerce has been recognized by the lower Federal courts and by a recent decision of the National Labor Relations Board. No matter how small its business, the activities of a particular commercial bank are associated in many ways with the transaction of interstate business; and Congress may properly determine that it is necessary for it to regulate all commercial banks in order to protect completely and adequately the flow of interstate commerce."

In a Supplement (dated November 29, 1944) to the memorandum published in 1933 and the 1941 memorandum, G. Howland Chase of the Board's Legal Division expressed the following opinion:

"When Mr. Wyatt wrote his opinion in 1932 there was ample room for a reasonable difference of opinion. When Mr. Hackley wrote his supplemental memorandum in January 1941, the trend of Supreme Court decisions had already swung markedly in the direction of upholding the power of the Federal government over matters formerly considered local or private in character. Since then, the trend has been even more marked, and although the present memorandum does not attempt to do much more than list the principal new decisions which would be pertinent, three of them, by themselves, would be almost enough to justify a categorical answer."

The question dealt with in those memoranda was, of course, whether Congress could prohibit the existence of State-chartered banks, compelling all commercial banks to be chartered under the National Bank Act. In our situation, the question is whether Congress may constitutionally limit the authority of the States to impose taxes on banks chartered and operating under their laws.

In my opinion, the conclusions reached in the earlier memoranda were correct, and have not been invalidated by subsequent events, either legislative or judicial. On the contrary, Supreme Court decisions during the past 35 years make it quite clear that Congress' power over interstate commerce reaches activities must less closely related to that commerce than is the business of banking. *Atlanta Motel v. U.S.*, 379 U.S. 241 (1964), and decisions cited on page 257: *Katzenbach v. McClung*, 379 U.S. 294 (1964).<sup>3</sup>

<sup>3</sup> Also *Perez v. U.S.*, decided April 26, 1971 (after this memorandum was drafted).

I further conclude that the Congressional power found to exist in those memoranda is sufficient also to support the limitations on State taxing power with which we are concerned. If Congress could terminate the existence of State banks, it may certainly take the lesser step of permitting them to exist subject to restrictions on the States' power to tax them.

(It is recognized that, in constitutional matters, the greater does not always include the less—that is, there is a doctrine of "unconstitutional conditions." However, in my judgment that doctrine is not applicable to the instant situation.)

Of the three bases for Congressional power, enumerated in the cited memoranda, the first and third are fully applicable to our proposition. The second—"the power to provide a national currency"—relied in part on judicial decisions relating to currency in the form of national bank notes, which were issued by national banks as late as 1935. However, the 1933 opinion pointed out, "Checks \* \* \* have to a very large extent taken the place of currency as a medium of payment" and otherwise assimilated commercial bank deposits (and drafts thereon) to paper and metal currency, which earlier had been the principal medium of exchange. In recent decades, of course, the importance of demand deposits as a medium of exchange has increased.

The foregoing reasoning presumably underlies positions heretofore taken by the Federal Reserve System in recommending banking legislation, and by the Congress in enacting such legislation. A special System report to the Congress, dated December 31, 1940, recommended that Congress "Make reserve requirements applicable to all banks receiving demand deposits regardless of whether or not they are members of the Federal Reserve System." (1940 Annual Report 69). And in letters to the Senate and House Banking Committees dated May 21, 1971, the Board recommended Federal legislation applying reserve requirements to all "depository institutions," defined to include every bank, etc., that accepts checking accounts. By the Act of December 23, 1969 (P.L. 91-151) Congress amended §18(g) of the Federal Deposit Insurance Act (12 U.S.C. 1828) to authorize the FDIC to impose interest ceilings, in specified circumstances, to deposits in noninsured banks and savings and loan associations. For what it is worth, in the legislative history of the 1969 Act I have found no indication that it occurred to anyone that there could be a question as to the authority of Congress thus to regulate all State depository institutions.

*Conclusion.*—In my opinion, Congress may constitutionally enact legislation restricting and regulating the power of the States to tax commercial banks doing business within their respective jurisdictions. This opinion applies to all such institutions, including State-chartered banks whose deposits are not insured by the Federal Deposit Insurance Corporation. The decisions of the Supreme Court to which I have referred appear to establish that Congress' power to regulate interstate commerce extends to the enactment of such legislation. In addition, such action by Congress probably would be sustained by the Supreme Court as a reasonable exercise of the power to provide a national currency and to create and maintain a banking system.

The CHAIRMAN. Senator Tower, before I call on you, let me say, I am going to have to leave for a time, probably an hour. Some time ago, I accepted a commitment to meet with a group and I am going to have to go. But, I do hope to get back while the hearings are still in progress; Senator Tower, take the witness. I apologize for having to leave.

Senator TOWER. Thank you very much. I am delighted to hear my colleague embrace the States rights philosophy here. [Laughter.]

I hope we can see that in future legislative deliberations.

Senator PROXMIER. You have been observant of what this Senator is trying to do?

Senator TOWER. I would like to explore the provisions of H.R. 15656 on the subject of discrimination. I note that the declaration of policy sets forth the policy of preventing taxation which will discriminate unfairly against the insured, commercial banks generally, or against out-of-State banks; or against national banks.

In section 203, there is a provision requiring that national banks be taxed the same as State-chartered banks, which seems to eliminate any discrimination between national and State chartered banks.

Section 204, authorizes the imposition of any tax that is imposed generally on a nondiscriminatory basis throughout the whole taxing jurisdiction.

Now, the question is whether section 203, and section 204 are designed to carry out the policy against discrimination set out in the declaration of policy.

Is this your understanding?

Mr. MITCHELL. Yes. I think so. On the question of discrimination in very general terms, we think, the protection of the Federal and State constitutions and the courts is generally adequate. The problem of protection against discrimination is primarily among banks rather than between banks and nonfinancial organizations.

Senator TOWER. Now, Governor, does section 204, rule out the bank share taxes or special franchise taxes on banks or other similar taxes applied only to commercial banks on the ground that they are not applied generally to all financial institutions, or all corporations and are therefore, not nondiscriminatory even though the overall tax burden on commercial banks is not any higher than the overall tax burden on these other institutions or corporations?

Mr. MITCHELL. No. The intention is that States may continue to tax banking enterprises by income taxes, bank share taxes, capital stock taxes or bank franchise taxes—any way in which they see fit. That is not ruled out by the word “generally,” or the phrase “on a nondiscriminatory basis.”

Senator TOWER. Thank you Governor Mitchell.

I might submit some additional questions to you in writing if you would not mind? That is all I have for you.

Senator PACKWOOD. I have no questions.

Senator PROXMIRE. I would like to follow up with just a few more questions.

I know the time is getting along and we have other witnesses. I will be as brief as I can.

Do you think that commercial banks are paying their fair share of State and local taxes at the present time?

Mr. MITCHELL. Well, you see, this gets into the question of what is fair?

I think, for example, they probably pay more taxes relative to any measure you want to use than savings and loan associations or credit unions; but how do they compare with nonfinancial enterprises?

I do not think the answer to that is clear. I do not think anybody has come up with an answer to that.

Senator PROXMIRE. You supplied me with some information that makes it, if not clear to everyone, at least clear in my mind. According to the figures you supplied me, commercial banks paid only 10 percent of their pretax net income to State and local governments whereas business corporations, as a whole, paid 44 percent.

In other words, the average business firm has a relative tax burden four times greater than the average bank.

The way I calculate what you said, a minute ago, this would not make much difference to the State and local governments if you did have a change in these bank taxes. But consider if the banks paid the same tax that other nonbank institutions paid, the way I calculate it, on the

basis of the figures you gave me; there would have been another \$2.3 billion available to State and local governments.

That is about half of the revenue sharing amount that President Nixon has called for this year.

Why is not net income a fair basis?

I am referring to table 1, of the table which you so graciously provided me and I ask that this be placed in the record (see p. 41).

MR. MITCHELL. I think the difference is nonfinancial businesses have substantial amounts of property and real estate which are taxed and banks have very little of this.

Senator PROXMIRE. That is why intangible property taxes seems to me to be able to equalize the burden. We are trying to get at net income—the way the tax and net income can be equalized.

Most of us thought that net income was a good basis for determining ability to pay.

MR. MITCHELL. Rates generally are the same.

Senator PROXMIRE. The rates are the same but the difference, as you know, is that the banks are very heavily in State and Federal obligations and those Federal obligations are exempt from State taxation.

If you have an income of \$10 million of which \$2 million is income from Federal obligations, and your costs are, say, \$8.5 million, you have a profit of \$1.5 million, actually; but because you can rule out \$2 million or interest from Federal obligations as income, you have a technical net loss as far as State government is concerned.

So you do not pay any taxes at all.

MR. MITCHELL. Well, under the present practice, the income from tax exempt obligations can be included in the tax base if the State adopts a franchise or excise tax based on net income.

Senator PROXMIRE. I do not expect that we are going to have anything like that. I do not mean to frighten anybody concerned about the increase in taxes on banks. I do not think it is going to be a four-fold increase or twofold increase.

What I am getting at, is under present circumstances, there is no evidence that the States are paying a fair share. I should say the banks are paying a fair share to the States and if they imposed something like the Florida intangible tax at the same rate and raised the same amount, all other things being equal, as I calculated it, it would raise about—according to the Library of Congress study—they would raise another \$350 million.

MR. MITCHELL. Well—

Senator PROXMIRE. You understand the gentleman at the table prepared these figures?

MR. LABOVITZ. Yes, I did.

MR. MITCHELL. Well, the estimate you have overlooks the fact that there are many States that have refused—either through a change in their constitution or because of a change in their law—to use intangibles for taxation and those States amount to about two-thirds of that total that you have there.

Senator PROXMIRE. Well, that is right, and there is nothing wrong with that. We are talking about whether or not they ought to have the right if they wish to do so.

MR. MITCHELL. If those States are excluded, the potential yield comes down to less than \$100 million.

Senator PROXMIRE. If Oregon decided to use the Florida system, I call the attention of Senator Packwood to this, the total assumed yield would be another \$2.8 million. That might be helpful to the State of Oregon.

Texas might raise another \$20 million.

Mr. MITCHELL. I have not seen this table, Senator. Mr. Labovitz just now gave it to me.

Senator PROXMIRE. I ask unanimous consent to insert this in the record (see p. 43).

At any rate, the way we calculate this on the basis of Mr. Labovitz' study, this would mean that the banks would be paying, not 10 percent, but about 15 percent of their pretax income to State and local governments.

It would still be far, far less than what nonfinancial institutions are paying. Do you regard that as an excessive burden, an inequitable burden?

Mr. MITCHELL. Well, I would put it this way, that if the States generally taxed the income of banks at the same rate as they tax nonfinancial business, that is as close to equality as you can get.

As far as the tax base is concerned, if the exemption for Government obligations were repealed, then I think you would remove all of the advantages banks have over nonfinancial institutions, if you are using net income as a criterion.

Senator PROXMIRE. What you are saying is this bill might prohibit inefficient taxation, but it would still permit the States to impose a franchise tax which would enable them to increase their yield if they wanted to do so, by another 50 percent or whatever; is that not correct?

Mr. MITCHELL. Well, we had a version of a bill which specifically provided that income received by banks on U.S. obligations would be taxable; it was not incorporated in the House bill.

Senator PROXMIRE. Will you submit the language on that for this committee?

Mr. MITCHELL. Yes. The draft language recommended by the Board would add to section 204 of H.R. 15656 the following sentence: "Interest on obligations of the United States may be excluded in determining the income of any such bank for purposes of taxation authorized by this section."

Senator PROXMIRE. I recall when I made my study—

Mr. MITCHELL. It is in our report.

Senator PROXMIRE (continuing). Of the almost complete lack of taxation on Wisconsin banks. I proposed a franchise tax in the Wisconsin Legislature.

You say that it is not authorized in this legislation in the House bill, at least, but you would—

Mr. MITCHELL. It is not in the House bill. It is in the Board recommendation.

Senator PROXMIRE. You recommend that?

Mr. MITCHELL. Yes, sir.

Senator PROXMIRE. May I ask you two other questions that are related to public deposits? They will be very brief.

The Federal Reserve bulletin indicates commercial banks hold over \$160 billion in Federal, State, and local securities whereas only \$70 billion is pledged as collateral for public deposits.

In other words, the banks have an extra \$96 billion in Government securities over and above the amount pledged.

Now, in view of this, do you think it is realistic to assume that banks would sell off an appreciable amount of Government securities if they were relieved of the pledging requirement?

Mr. MITCHELL. Well, no. Loan business is not all that strong right now. Once business loans start to go up, banks are going to sell off a lot of these securities as they always have. There are always banks that have securities for collateral; small banks virtually never run out of securities for collateral. But the large banks do.

Senator PROXMIRE. I am a little puzzled by that because the testimony we have had before our Joint Economic Committee in the last week or so, indicates business has been excellent and that it is moving along.

Mr. MITCHELL. Business is good, but loan demand has not picked up.

Senator PROXMIRE. Is that not one of the best indicators of business activity? Does not loan activity pick up when the business picks up?

Mr. MITCHELL. Corporations have been in a relatively liquid position.

Senator PROXMIRE. Of course, newly empowered tax legislation has changed the cash flow somewhat. That might have some bearing on it.

If a sale of Government securities during a credit shortage became a serious problem, why could not the Feds direct the banks not to sell Government securities?

Mr. MITCHELL. Well, I do not think they would sell them if they wanted the public deposits. They would have to have them for pledging purposes. But, if you remove that, if you remove that incentive to hold Government securities, then there will be less of a demand for them than there is at the present time.

Senator PROXMIRE. That is true. There would be less demand and that certainly is an excellent point. Would there not be a more stable situation? One of the great difficulties for State and local obligations as I understand it, is that it is a feast and famine situation.

The banks are a big buyer, get in and out very fast in a very big way. When they sell the rates go high, and that means the State and local governments have to stop their activity. This often coincides with a restriction in the housing area, too.

So, two of the areas where socially—and from an economic priority basis we like to see activity, housing and State and Government investment, that is what suffers from the crunch.

Mr. MITCHELL. Well, I think pledging may be a marginal factor for some banks. But it may be a major factor for other banks. Therefore, there is an advantage the Treasury derives from that use of Government securities for pledging purposes.

It is like the advantage that Treasury securities derive because of the Federal open market operations. It is an additional reason for holding those Government securities.

If you remove this one single advantage, it would not help the market. It would hurt it.

Senator PROXMIRE. Well, I think it would do this. It would mean that the banks would be less likely to invest in State obligations, for example, in periods like the present or other periods when they have excess funds. You could prevent them from taking a toboggan ride when the crunch comes.

Mr. MITCHELL. I think that is right.

Senator PROXMIRE. Senator Tower, I beg your pardon, Senator Brock?

Senator BROCK. Mr. Mitchell, I gather the essence of your statement—and I apologize for being late—the concern that—the removal of the incentive or the pledging would jeopardize the bonds market. The Senator from Wisconsin feels that it would stabilize the market, but I believe it would stabilize it at a lower level. Is that not a fair statement, and are you not going to have reduced interest in the market, therefore would you not have a higher fluctuation than today?

Senator PROXMIRE. If the Senator would yield, I think that is an excellent point. I did not mean to champion this position. I think that is an excellent suggestion. I think you are right, no question about it.

Mr. MITCHELL. Well, of course, the Treasury securities are a highly prized market instrument. They are available at any time and you can sell them at any time.

They have a lot of advantages. Among the advantages, they have is this use for pledging purposes and I think if that were removed, there would be at least some banks that would hold fewer Treasury securities at certain times.

So, retaining the pledging requirement in effect does, I think, as you put it, stabilize their prices at a level or somewhat higher than it would otherwise be.

Senator BROCK. The fact of the matter is if a bank were free to go back and forth; if there were in effect, no pledging, you would have greater instability, you would have greater swings as the market fluctuated, banks would go where they could get the higher rate or return, would they not?

If there are other instruments which have a greater yield and there is no requirement for this offset which a pledge represents, they can go in and out even more readily, more rapidly than they do today.

I think you are going to have more dislocation and more confusion in the market itself.

Mr. MITCHELL. That could very well be.

Senator BROCK. Pardon?

Mr. MITCHELL. That could very well be.

Senator BROCK. Very well, thank you very much.

Senator PROXMIRE. Senator Tower?

Senator TOWER. No further questions, Mr. Chairman.

Senator PROXMIRE. Thank you very much. You are most helpful and most responsive.

Mr. MITCHELL. Thank you, sir.

(Full statement of George W. Mitchell and additional information follows:)

STATEMENT OF GEORGE W. MITCHELL, MEMBER, BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM

I appreciate this opportunity to testify on behalf of the Board of Governors on legislation clarifying the powers of the States to tax banks. Legislation is needed for three reasons. First, taxation of intangibles owned by banks should be prohibited. Second, the imposition outside the home State of taxes measured by net income, capital stock, or gross receipts, and other "doing business" taxes, should be deferred until such time as uniform and equitable methods may be devised to determine jurisdiction to tax and to divide the tax base among States. Third, discriminatory forms of taxation that might discourage interstate and

interregional credit movements should be avoided. To accomplish these three broad objectives, the Board recommends enactment of the provisions incorporated in title II of H.R. 15656.

While I have mentioned three broad objectives, the recommendations in the Board's report to Congress, submitted May 4, 1971, were more detailed. Let me turn now to those recommendations and their relation to H.R. 15656.

At the outset, the Board's report suggested that "it would be desirable that the restrictions proposed in our recommendations apply to all commercial banks (national and State) and all other depository institutions (savings banks, savings and loan associations, and credit unions)." H.R. 15656 applies only to commercial banks insured by the Federal Deposit Insurance Corporation. The Board's recommendation of broader coverage was based on the premise that any statutory protections accorded to commercial banks should, as a matter of equity, be extended to their close competitors. I recognize, however, that in some cases these competitors have looked upon this suggestion as reflecting an intention to expose them to new tax burdens rather than protect them. Congress therefore may prefer to restrict this legislation to commercial banks, as H.R. 15656 would do.

#### TAXATION OF INTANGIBLES

The Board's report recommended that Congress make permanent "the present denial of authority for States and their subdivisions to impose taxes on intangible personal property owned by national banks and extend that denial to intangible personal property owned by State banks and other depository institutions."

This recommendation related to *ad valorem* taxation of intangible personal property owned by banks. It does not concern taxes on bank shares or deposits or franchise taxes on capital stock. The recommendation rests on grounds of equity and economic impact.

*Ad valorem* taxes on intangible property now yield little revenue to the States. The number of States imposing such taxes has been diminishing, reflecting the fact that intangibles taxes are extremely difficult to enforce effectively and have strongly adverse economic impacts when they are enforced. In an authoritative study a few years ago of the economics of the property tax, Professor Dick Netzer of New York University observed that—

"The progressive withdrawal of particular classes of personal property from the scope of the general property tax represents a surrender to reality. The process of exemption has gone furthest for those classes which pose the greatest difficulties in regard to discovery and valuation of the assets and in regard to the economic consequences of uniform valuation and taxation even where these are possible.

"Intangibles present the extreme case, for they are either readily concealed or highly mobile (or both) and thus hard to locate on assessment day; moreover, the incentive to evade or avoid the assessor is substantial, since investment in the form of intangible frequently yields considerably lower rates of return than comparable investment in tangible assets. Hence a uniform area-wide property tax rate is likely to absorb a substantially larger part of the (realized or imputed) return from intangibles than of the return from other assets, especially when one considers that the assessor cannot as readily underassess fixed value claims, such as bank deposits, as he can other asset." (Netzer, *Economics of the Property Tax*, 1966, pp. 140-41.)

Netzer went on to describe the large shifts of bank deposits out of Chicago banks just before the annual assessment date, April 1—shifts so large that they have a discernible impact on Treasury bill yields. These assessment-day disturbances in the money markets of Chicago were described again in the *Wall Street Journal* of July 18 this year: "April 1 is assessment day, and only that cash on deposit that day in Illinois is considered taxable by the state. Therefore, shortly before April 1, many big companies convert their cash balances into government securities, which are tax-exempt, or simply transfer their funds across the border and beyond the reach of the Illinois tax man."

If Public Law 91-156 had been in effect when he wrote, Netzer might have added that the difficulties that prevent effective enforcement as to nonbank businesses might not confront the tax assessor in applying these taxes to intangibles owned by banks. Banks cannot move their base of operations from one taxing jurisdiction to another; they are closely supervised, with published balance sheets; and tax assessors cannot readily undervalue the fixed claims that make up bank assets to the degree that they generally undervalue other types of assets.

But application of intangibles taxes to banks would be inequitable, and would have undesirable economic effects. Virtually all the assets of banks are in the form of intangibles, whereas this class of property is much less important for nonfinancial businesses. So even though intangibles taxes were to be levied on all corporations they would bear far more heavily on banks than on general business firms.

Moreover, such a tax would tend to distort financial flows, with some consequent loss in economic efficiency. For example, banks might then invest less in taxable assets such as loans to businesses and consumers, and more in tax-exempt municipal bonds. Or flows of savings might be diverted from banks in States that imposed such a tax and into banks in States that did not. The process of financial intermediation performed by banks and other depository institutions is particularly vulnerable to an intangibles tax since the duplication of financial assets that is inherent in the flow of savings, first into deposits of these institutions and then into customer loans, would expose savings flowing through intermediaries to an additional layer of taxation. This extra exposure does not occur where funds flow directly from savers to ultimate borrowers.

The staff study submitted with the Board report included a section summarizing arguments against allowing States to tax bank-owned intangible assets. Because a full quotation would involve repetition of some of the points I have already presented, I shall simply submit that section of the report for the record, as follows:

"(1) The territorial immobility of banks and the fact that they are closely regulated probably would lead to considerably heavier taxation of their intangibles than of similar assets of nonfinancial corporations. Intangibles in nature and in form are mobile, and opportunities to choose the business situs of such assets on the basis of tax considerations ordinarily are available to most firms conducting dispersed operations. However equal they might be under the law, in practice banks and some other classes of financial institutions would be at a relative disadvantage compared to firms in nonfinancial business, especially large firms, if barriers to State taxation of intangibles were eliminated.

"(2) A general tax on intangibles would have a discriminatory impact against the process of intermediation as distinguished from direct market financing, since the layering of financial assets that is inherent in intermediation would expose savings that flow through intermediaries to double or multiple taxation, whereas those placed directly with borrowers would be taxed only once. Moreover, a tax on intangible assets would be easily enforceable against institutions but the holdings of individuals would largely escape assessment and taxation.

"(3) Unless most intangibles are taxed practically everywhere and to all businesses, and with substantially equal effectiveness in all jurisdictions, the intangible personal property tax has distinctly unneutral effects upon geographic and inter-industry movements of capital. If the intangibles tax were imposed in only a few States, or if administration was more vigorous and effective in some States than in others, the taxed banks' market power to recoup the tax by obtaining higher interest rates on loans and securities would be severely limited. Banking capital would tend to migrate toward non-taxing States or low-rate States.

"(4) An intangibles tax would fall more heavily on Federal Reserve member banks than non-member banks and would constitute an additional cost of membership. This is because member banks are required to hold all their legal reserves in a form that earns no interest (vault cash or balances at the Reserve banks), whereas non-member banks generally may hold their reserves in earning forms or in balances with other banks for which correspondent bank services are received. The nearly universal practice of determining assessments on a single predetermined date each year might enable member banks to mitigate this difference by acting to reduce reserves on the assessment date. However, such adjustments would not remain possible if pressures to minimize market disruptions and tax avoidance impelled States to assess on the basis of averages.

"(5) Exclusion of tax-exempt obligations from the tax base means that an intangibles tax would apply unevenly to individual banks, rather than in a uniform relationship to the volume of their intangible assets. Moreover, a tax-induced preference for tax-exempt holdings might have incidental effects, such as a tendency to divert banks from helping to finance the private sector since this would involve acquisition of taxable assets. If a State taxed public debt instruments issued by other States and their subdivisions, this might narrow the market for out-of-State obligations while strengthening the market for home-State securities, since they are usually exempt.

"(6) The possibility that intangibles might be subjected to taxation in States other than the home State of the bank—that is, by the State of the debtor—might create apprehensions and protective reactions on the part of banks. For example, concern about compliance burdens and uncertainty about potential increases in the rate or coverage of such taxes might lead to limitation of credit operation in the foreign taxing States; any such impediments to the interstate flow of credit and commerce would hamper the efficient utilization of resources.

"(7) Denial of authority to tax bank intangibles would not be a major limitation on the States or a major loss to them, for several reasons:

(a) They never have had this authority with respect to national banks and therefore have applied it only in rare instances to State banks. In calling for amendment of section 5219, States did not make a special point of this prohibition, as they did with respect to sales, documentary, and some other types of taxes.

(b) Many States exempt all personal property or all intangibles and the trend toward exemption is continuing. Some States exempt designated classes of intangibles and tax selected categories at special low rates in recognition of problems of double taxation, the confiscatory potentials of property tax rates when related to yields on intangibles, difficulties of enforcement and administration, and the geographic shifts of investment that might be induced by full-rate taxation. It is doubtful that taxes on intangibles other than bank deposits and shares currently contribute as much as one-third of 1 percent of all State-local tax revenues.

(c) In any event, a significant portion of bank-held intangibles is not available for State taxation because of the exclusion of Federal government obligations from the property tax base.

"On balance, it appears that the prospective removal of the prohibition on taxing intangibles owned by national banks could have substantial effects, concentrated in that sector of the economy which is engaged in the basic economic function of financial intermediation. The interstate flow of credit and commerce might be hindered. In practice such a tax would be discriminatory against banks and other financial institutions, however equitable and even-handed the formulation of the State tax laws." (Part II of the Board report, pp. 54-5.)

Over the years the number of States retaining an intangibles tax has been diminishing, reflecting dissatisfaction with the tax as inequitable and difficult to enforce. This trend is continuing as indicated by the 1970 repeal of the *ad valorem* intangibles tax in Iowa, conversion from an *ad valorem* to a gross earnings tax in Kansas, and adoption of a constitutional amendment in Illinois providing for the elimination of all personal property taxation by 1979. It would be unfortunate if Public Law 91-156 should lead to a reversal of this trend by encouraging States to focus upon bank-owned assets simply because they are comparatively easy to assess.

#### TAXATION BY STATES OTHER THAN THE HOME STATE

The second recommendation in the Board's report related to taxation outside the home State. The recommendation was to "limit the circumstances in which national banks, State banks, and other depository institutions may be subject to State or local government taxes on or measured by net income, gross receipts, or capital stock, or to other 'doing business' taxes in a State other than the State of the principal office, and prescribe rules for such taxation."

For national banks, the law now in effect confers exclusive taxing authority on the domiciliary State. That limitation would terminate December 31, 1972, if the "permanent amendment" of section 5219 becomes effective, as it will unless Congress takes action at this session. Under the "permanent amendment" and under the Board's recommendation, the home State might be required to divide the tax base of its domiciliary banks, both State and national, with other States in which the banks are "doing business."

H.R. 15656 would continue the present exclusive jurisdiction in the domiciliary State and extend this Federal statutory provision to all insured commercial banks. The section on policy includes a declaration that "doing business" taxes outside the home State should be deferred until uniform and equitable methods may be developed for determining jurisdiction to tax and for dividing the tax base among States. We consider this a realistic approach to a complicated problem.

The Board report recognized that its recommendation presupposes the formulation of clear jurisdictional principles for determining when a State may tax

an out-of-State bank and standard rules for measuring what part of the base is subject to tax in any given State. The underlying objective was "to forestall the development of significant impediments to \* \* \* mobility [of funds] while safeguarding the authority of the States to collect taxes in circumstances where an outside bank \* \* \* has established a clear relationship to the taxing State \* \* \* through a physical presence or a pattern of sustained and substantial operations." Mere occasional and transitory business activities in a State should not subject a bank to "doing business" taxes in that State. It seems prudent to suggest that if banks are now to be exposed for the first time to multistate taxation (as they would be under the "permanent amendment" in Public Law 91-156), they should from the very outset be given some degree of statutory protection from the kinds of unsettling diversities and uncertainties that characterize State taxation of interstate manufacturing and mercantile businesses.

There is at present no consensus among State taxing authorities or in the banking community about the precise methods for providing such protection, particularly as to rules for division of the tax base.

Equitable division requires either separate accounting or apportionment of the tax base by a standard formula. Separate accounting is a procedure for nominal separation of affiliated enterprises which the States generally have found difficult to police and evaluate. On the other hand, where States use a formula to apportion the tax base of nonbank businesses, they commonly use one or more of three basic factors: property, payrolls, and sales. These factors are not particularly suited to the banking business. Moreover, as the Board report indicated, if interstate division of the taxable net income of banks were to conform closely to procedures applied to other businesses by most States, there would be—with present lending practices—comparatively little allocation of the tax base to States other than the home State of the banks. In a formal sense, virtually all business of commercial banks is conducted in the domiciliary State. Banking practices may change, of course. State allocation procedures also may change in a variety of ways unless Federal statutory limitations are enacted to assure uniformity.

Formulation of satisfactory uniform standards for multiple State taxation will be a time-consuming and difficult process, requiring a major coordinated effort by State tax authorities, in consultation with representatives of the banking industry. H.R. 15656 provides for a study by the Board of Governors to develop such standards. The Board is hopeful that this provision will be amended to place responsibility for the study in the Treasury Department or the Advisory Commission on Intergovernmental Relations. These two agencies are well qualified to deal with the technical complexities and the consultative aspects of the problem, and the Board is not.

#### DISCRIMINATORY TAXATION

The third recommendation in the Board's report was to prohibit "imposition of discriminatory or more onerous license, privilege, or other similar 'doing business' taxes upon out-of-state depository institutions than would be imposed upon these institutions if chartered by the taxing State." This particular form of discriminatory taxation would not be allowed under H.R. 15656, since it would authorize "doing business" taxes only in the domiciliary State. More broadly, H.R. 15656 would expressly prohibit discrimination against out-of-State banks in any form of taxation, and would require equal treatment of national banks and State banks.

It is difficult to frame a statutory prohibition against other forms of discrimination that would add substance to the protections now incorporated in the Federal and State constitutions. Uniformity is not the answer, since some kinds of nominally uniform taxes, such as *ad valorem* taxes on intangibles, if applied equally to banks and nonbank businesses, would hit banks unduly hard. Therefore, as was pointed out in the staff study that accompanied the Board's report, "it may be necessary in the interests of equity and economic neutrality to classify banks and other financial institutions, particularly depository institutions, separately from other businesses in order that tax provisions may be adjusted to their special characteristics." Accordingly, the Board recommends continuation of the general standard against discrimination established in Public Law 91-156, without the addition of specific statutory standards intended to assure uniform treatment for banks and nonbank businesses. H.R. 15656 adopts this approach by authorizing taxation of insured banks only where the tax is imposed generally throughout the taxing jurisdiction on a nondiscriminatory basis.

## INCOME ON U.S. OBLIGATIONS ; TREATMENT OF COIN AND CURRENCY

The fourth and fifth recommendations in the Board's report involved narrower questions. Recommendation 4 was that States should be authorized "to include, in the measure of otherwise valid direct net income taxes, the income realized by banks and other depository institutions from Federal Government obligations." Under present law (31 U.S.C. 742), States may include such income in the tax base for a franchise or excise tax measured by net income, but not for a direct tax on income. There is no economic difference between these two types of taxes, and the present exemption restricts the choice domiciliary States should have in taxing bank income. However, the St Germain Subcommittee of the House Committee on Banking and Currency decided not to include provisions carrying out this recommendation in H.R. 15656. I understand that this decision reflects questions of committee jurisdiction.

Recommendation 5 was that "coins and paper currency [should] be considered intangible personal property for State and local tax purposes." This recommendation is incorporated in the definition of "intangible personal property" in H.R. 15656. Cash and currency are treated as intangibles under section 5219 of the Revised Statutes as now in effect, but the specification would lapse at the end of 1972 if there were no further legislation.

## RELATIVE TAX BURDENS

It may be useful to mention briefly a question that is sometimes raised in discussions of State taxation of banks. The question is whether banks pay their fair share of taxes, as compared with other businesses. This question was examined in detail in appendix 9 of the Board's report. For reasons summarized at pages 18 and 19 of Part II of the Board's report, the report does not include a comparison of tax treatment of banks with that of other businesses. We know of no way to make such comparisons in a meaningful and objective fashion on the basis of available data.

As far as the pending legislation is concerned, the relevant point is that H.R. 15656 would not take away any existing source of revenue nor would it impose significant Federal limits on future taxation. The continued prohibition of taxes on bank-owned intangible personal property would become important in terms of the revenues involved only if States were to reverse the long-continued trend away from taxation of intangibles. The provisions relating to taxation of out-of-State banks would not necessarily reduce total taxes below what they would otherwise be. In fact, they might produce the opposite result for reasons that were pointed out in the Board report:

"The aggregate of taxes paid by any individual bank or other depository institution probably would be reduced by multiple State taxation as compared with taxation confined to the headquarters State because applicable tax rates in the home State (especially in the major banking center States) may be higher than in other States, and some States may not tax the out-of-State institution." (Pages 4-5.)

The importance of the multistate taxation issues lies in the fact, also noted in the Board report, that—"In some instances the added costs of acquiring technical competence regarding the differing tax laws and procedures of all States where business is done, maintaining records needed to determine which taxes are applicable and the amount of liability, and preparing and filing returns in all affected States may be even greater than the taxes." (Page 5.)

The objective of H.R. 15656 is not to relieve banks of any taxes comparable to those borne by other enterprises, but rather to avoid excessive compliance costs and the erection of avoidable barriers to interstate credit flows. As the Board said in its report,

"Such barriers would be raised not only by the imposition of the tax itself but also if there ensued uncertainty, controversy, and litigation of the sort that for decades have characterized taxation of interstate mercantile and manufacturing businesses. Uncertainties about potential tax liabilities and concern about compliance burdens could become material factors in decisions to make particular loans or investments." (Page 5.)

## SUMMARY : STATE TAXATION OF BANKS

Admittedly, the central questions involved in Federal legislation pertaining to State and local taxation of banks are quite technical and complex. But they are

important for the industry and for some banks and local governments. The Board's report and the staff studies which preceded it have been furnished to the House and Senate Committees. These documents explore the underlying issues in greater detail. The point that I would stress today is that the restraints on the taxing powers of the States incorporated in H.R. 15656 will not, in my judgment, cut off important potential sources of revenue, but they do offer assurance against imposition of taxes that might impair the ability of the banking system to contribute to the efficient allocation of the Nation's credit resources.

#### FULL INSURANCE OF PUBLIC DEPOSITS

The bulk of my statement has dealt with taxation of banks, since I had understood that would be the subject matter of the hearing. I have since been informed that the hearing would be broadened to cover two additional subjects incorporated in an amendment intended to be proposed by Senator Proxmire, introduced July 26. Title III of the Proxmire amendment provides that deposits by Federal, State, or local governments in institutions insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation shall be fully covered by deposit insurance, notwithstanding the \$20,000 limit generally applicable to other deposits. The FDIC and the FSLIC would be authorized to limit the aggregate amount of such deposits in any individual institution on the basis of the size of the institution in terms of its assets. The Board recommends against enactment of title III.

Commercial banks invest heavily in Treasury and municipal securities. At the end of last year they held \$160 billion of U.S. Treasury, Federal agency, and municipal securities. An estimated \$70 billion of these were pledged as security against \$59 billion in public deposits. Full insurance would eventually lead to removal of pledging requirements and reduce bank demands for these securities. Borrowing costs to the Treasury and to State and local governments would thereby be raised.

Moreover, if the principle of full insurance were later extended to cover private as well as public deposits, incentives for good bank management could be significantly weakened. Finally, the Board believes it would be unwise to divert active or short-term time deposits from banks to savings and loan associations, as could result if title III were enacted. Public deposits are made up of funds needed for operating purposes, and of temporary overruns or surpluses. Public policy should not encourage investment of funds of this kind in long-term illiquid assets such as mortgages.

#### CASHING OF GOVERNMENT CHECKS

Title II of the Proxmire amendment would prohibit any institution insured by FDIC and FSLIC from refusing to cash a Government check upon presentation by the payee on the ground that he does not have an account at the institution, provided he furnishes adequate identification. It would also prohibit such institutions from charging the payee for cashing the check. The Treasury would prescribe regulations to carry out these provisions.

Two elements of cost would be involved in providing such check-cashing services: losses on checks cashed for people who are not entitled to payment, and routine handling costs. Losses due to false identification could be minimized, but not entirely eliminated, if identification procedures were carefully worked out. Routine handling costs, however, cannot be readily absorbed, particularly if the identification procedures proved to be time-consuming. Financial institutions would have to absorb these costs or pass them on to their customers, unless some arrangements can be made for the Government to reimburse them for their added expense.

In an analogous situation, when business payrolls result in a large number of checks being presented for cash at local banks, employer firms maintain balances at the banks at levels that will compensate them for the check-cashing service. I understand that in a few instances compensation has taken the form of fees rather than maintenance of deposit balances—a practice that may become more widespread as cost accounting techniques are perfected.

If banks are required to cash Government checks free of charge, the impact will vary among individual banks; in some cases the added costs could be substantial. We would hope that arrangements could be made, including guarantees against liability where the Treasury's identification procedures are compiled with, to avoid imposing unfair cost burdens on particular institutions.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
Washington, D.C., August 1, 1972.

Hon. WILLIAM PROXMIRE,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR PROXMIRE: I am writing in reply to your letter of July 24, in which you asked for estimates of the total State and local taxes paid by commercial banks in 1971 and 1972, along with their net income before taxes.

Although we do not have the underlying data needed to provide an estimate for 1972, the attached tables provide rough estimates of these data for 1969, 1970, and 1971. As explained below, these estimates involve methodology and projection techniques which are approximate at best, and the different categories of data may not be completely consistent, but the estimates are as close as we can come at this time.

A brief description of the sources and the methodology for deriving the data in Table I follows.

1. *Net Income Before Taxes, All Business Enterprise.*—These figures are simply the sum of corporate profits before taxes and proprietors' net income before taxes, a component of personal income. They are revised data which will soon be published in the July 1972 Survey of Current Business.

2. *Net Income Before Taxes, Commercial Banks.*—These figures are taken from the Federal Reserve Bulletin (see footnote 2, Table I). I doubt that the data are fully consistent with the NIA estimate of net income of all business enterprise.

3. *State-Local Taxes Paid By All Business Enterprise.*—There are no published data that fit this category. In Table II we show how the figures were calculated using Department of Commerce data, published and unpublished. The methodology is the same as that used in the Federal Reserve study, *State and Local Taxation of Banks*, Part III, Appendix A. The methodology is questionable because of timing differences in the figures for "Total State-Local Taxes" and the components which are subtracted from this figure to derive total business taxes.

4. *State-Local Taxes Paid By Commercial Banks.*—The FRB study, *State and Local Taxation of Banks*, provided information on State-local taxes for calendar 1969 only. The source of the data on commercial bank taxes was a survey of taxes paid by insured banks in one year, 1969. The figure from the survey, \$623 million, is shown in Table I. The estimate for 1970 and 1971 was obtained in a naive way by applying the changes in total State-local taxes to the 1969 survey figure for commercial banks. The underlying data are shown in Table III. This projection assumes that the major components of bank taxes grew at the same rate as similar components of all taxes paid to State and local governments.

Sincerely yours,

GEORGE W. MITCHELL.

TABLE I.—ESTIMATES OF NET INCOME AND TAXES PAID TO STATE AND LOCAL GOVERNMENTS FOR ALL BUSINESS ENTERPRISE AND FOR COMMERCIAL BANKS

[In billions of dollars]

Calendar	Net income before taxes		State-local taxes paid by—	
	All business enterprise <sup>1</sup>	Commercial banks <sup>2</sup>	All business enterprise <sup>3</sup>	Insured commercial banks <sup>4</sup>
1969.....	152.1	6.7	57.4	0.623
1970.....	141.1	7.1	63.3	.670
1971.....	153.3	6.7	68.8	.705

<sup>1</sup> Sum of corporate profits before taxes and proprietors income. Data to be published in U.S. Department of Commerce, Survey of Current Business, July 1972.

<sup>2</sup> Federal reserve bulletin, August 1970, A-98; June 1971 A-94 and A-95; May 1972, A-98 and A-99, "Income Before Income Taxes and Security Gains and Losses."

<sup>3</sup> Calculated according to method shown in attached table II.

<sup>4</sup> The 1969 figure is taken from the Federal Reserve Survey of State and Local Tax Expenses of Insured Commercial Banks. The 1970 and 1971 estimates were obtained by applying the 1970 and 1971 changes in various categories of total State-local taxes to the 1969 survey figures for banks. See underlying data in attached table III.

TABLE II.—CALCULATION OF STATE AND LOCAL TAXES PAID BY ALL BUSINESS ENTERPRISE<sup>1</sup>

[In millions of dollars]

	Calendar year—		
	1969	1970	1971
Total State-local taxes <sup>2</sup> .....	82,826	91,578	100,724
Less personal tax and nontax receipts <sup>3</sup> .....	21,711	24,325	27,434
Plus nontaxes <sup>3</sup> .....	7,692	8,864	10,100
Less taxes on owner-occupied houses classified under business property taxes <sup>4</sup> .....	11,454	12,863	14,569
Total.....	57,353	63,254	68,821

<sup>1</sup> This calculation is consistent with the method employed in the Federal Reserve Board study, "State and Local Taxation of Banks," pt. III, app. 3, footnote to table 14, p. 40.

<sup>2</sup> U.S. Department of Commerce, "Quarterly Summary of State and Local Tax Revenue," October-December 1971 and October-December 1972.

<sup>3</sup> Data to be published July 1972, Survey of Current Business table 3.3.

<sup>4</sup> Confidential figures supplied by Commerce.

TABLE III.—TAXES PAID TO STATE AND LOCAL GOVERNMENTS

Type of tax	All taxes (millions) <sup>1</sup>			Taxes of insured commercial banks (thousands)		
	1969	1970	1971	1969 <sup>2</sup>	1970 <sup>3</sup>	1971 <sup>3</sup>
1. Real property and tangible personal property.....	\$33,556	\$37,502	\$41,306	\$184,154	\$205,800	\$226,700
2. Corporate income taxes.....	3,499	3,585	3,433	235,160	240,900	230,700
3. Sales and gross receipts.....	15,134	16,988	8,958	18,513	20,800	23,200
4. Other <sup>4</sup> .....	30,636	33,503	37,027	185,225	202,600	223,900
Total.....	82,826	91,578	100,724	623,052	670,100	704,500

<sup>1</sup> Source: U.S. Department of Commerce, "Quarterly Summary of State and Local Tax Revenue," October-December 1971 and October-December 1972.

<sup>2</sup> Federal Reserve Survey of State and Local Tax Expenses of Insured Commercial Banks, 1969. The survey categories have been grouped to conform with the breakdown in the all taxes category.

<sup>3</sup> The survey data is available for only 1 year, 1969. The 1970 and 1971 estimates are based on changes in relevant components of "all taxes" paid to State-local governments.

<sup>4</sup> Includes personal income taxes in "all taxes" category only.

THE LIBRARY OF CONGRESS,  
CONGRESSIONAL RESEARCH SERVICE,  
Washington, D.C., July 31, 1972.

To: Mr. Kenneth A. McLean, Senate Committee on Banking, Housing, and Urban Affairs.

From: I. M. Labovitz, Senior Specialist in Social Welfare.

Subject: Estimates of potential yield of property tax on bank-owned intangible personal property assuming Florida rate and assessment base.

The accompanying table, prepared in response to your request, presents hypothetical estimates of the potential amount of State and local taxes that would be levied upon intangible personal property owned by insured commercial banks in the several States if each State employed this tax with the effective rate and base used in estimates for the State of Florida for 1972.

A report by the Federal Reserve Board to your Committee, submitted June 8, 1972 (and published as part IV in the Committee print of June, 1972, on State and Local Taxation of Banks), stated that an analysis of State tax structures and information supplied by State tax administrators indicated that there was virtually no prospect for imposition of ad valorem taxes on bank-owned assets during 1972 in any State except Florida. In that State, tax regulations had been amended in 1970 to provide that the tax on intangibles would become effective automatically for both State and national banks on January 1, 1972, if authority to tax intangible personal property of national banks had become available (under P.L. 91-156).

The potential yield for Florida was estimated at about \$9 million on specified intangible assets.

The table shows the potential yield in each State of a tax on roughly the same basis and at the same effective rate as were used in the \$9 million estimate for Florida. In requesting these estimates, the Committee recognized that under present State constitutional provisions, statutes, tax policies, and practices, many States do not tax any intangible property according to value, and that some States employ other types of imposts explicitly or implicitly in lieu of ad valorem taxes on intangibles. It was recognized, too, that other States might impose the tax on some types of intangibles that are not included in the Florida tax base or might apply higher tax rates. The comprehensive estimates based on the Florida example are intended to provide order-of-magnitude estimates, at best.

The table includes a rough division of States into those which (1) do not now tax intangible personal property generally to any individuals or business in the State under a general, classified, or selective property tax, and (2) States where the law provides for such taxation in at least some measure—often limited to selected categories of property or imposed at special low rates. In several States where intangibles are legally subject to property taxation, the law is not enforced or is applied only sporadically. In some States there is a mingling of intangible property with tangibles or even with real property in the assessment process. Consequently, the hypothetical estimates need to be interpreted in the light of the particular tax policies and practices of the individual States.

HYPOTHETICAL YIELD OF PERSONAL PROPERTY TAX IF EFFECTIVE RATE OF FLORIDA TAX ON INTANGIBLE PERSONAL PROPERTY WERE APPLIED TO ASSETS OF INSURED COMMERCIAL BANKS, BY STATES, 1971

[In millions of dollars]

State	Assumed taxable base, selected bank assets <sup>1</sup>	Assumed yield, applying Florida effective rate <sup>2</sup>		
		Total	States where constitution or statute exempts intangibles generally <sup>3</sup>	States where some intangibles are legally subject to property tax <sup>4</sup>
Alabama.....	\$3,205.3	\$3.5	\$3.5	-----
Alaska.....	315.5	.3	-----	\$0.3
Arizona.....	2,590.5	2.9	-----	2.9
Arkansas.....	1,756.6	1.9	-----	1.9
California.....	32,129.0	35.5	35.5	-----
Colorado.....	2,973.8	3.3	3.3	-----
Connecticut.....	3,155.3	3.5	3.5	-----
Delaware.....	744.9	.8	-----	.8
District of Columbia.....	1,507.5	1.7	1.7	-----
Florida.....	8,145.4	9.0	-----	9.0
Georgia.....	5,106.7	5.6	-----	5.6
Hawaii.....	1,020.3	1.1	1.1	-----
Idaho.....	929.8	1.0	-----	1.0
Illinois.....	24,471.3	27.0	-----	27.0
Indiana.....	6,144.3	6.8	-----	6.8
Iowa.....	3,829.0	4.2	4.2	-----
Kansas.....	3,177.9	3.5	3.5	-----
Kentucky.....	2,920.2	3.2	-----	3.2
Louisiana.....	3,785.0	4.2	-----	4.2
Maine.....	799.2	.9	-----	.9
Maryland.....	3,100.7	3.4	3.4	-----
Massachusetts.....	8,126.7	9.0	9.0	-----
Michigan.....	10,879.9	12.0	-----	12.0
Minnesota.....	5,418.1	6.0	6.0	-----
Mississippi.....	1,899.6	2.1	-----	2.1
Missouri.....	6,856.5	7.6	7.6	-----
Montana.....	982.7	1.1	-----	1.1
Nebraska.....	2,429.3	2.7	2.7	-----
Nevada.....	683.2	.8	-----	.8
New Hampshire.....	552.3	.6	-----	.6
New Jersey.....	8,462.0	9.3	-----	9.3
New Mexico.....	1,076.6	1.2	1.2	-----
New York.....	67,292.7	74.4	74.4	-----
North Carolina.....	5,035.3	5.6	-----	5.6
North Dakota.....	788.4	.9	.9	-----
Ohio.....	12,945.5	14.3	-----	14.3
Oklahoma.....	3,684.2	4.1	4.1	-----
Oregon.....	2,512.2	2.8	2.8	-----
Pennsylvania.....	19,546.6	21.6	-----	21.6
Rhode Island.....	974.8	1.1	-----	1.1
South Carolina.....	1,650.6	1.8	1.8	-----

HYPOTHETICAL YIELD OF PERSONAL PROPERTY TAX IF EFFECTIVE RATE OF FLORIDA TAX ON INTANGIBLE PERSONAL PROPERTY WERE APPLIED TO ASSETS OF INSURED COMMERCIAL BANKS, BY STATES, 1971—Con.

[In millions of dollars]

State	Assumed taxable base, selected bank assets <sup>1</sup>	Assumed yield, applying Florida effective rate <sup>2</sup>		
		Total	States where constitution or statute exempts intangibles generally <sup>3</sup>	States where some intangibles are legally subject to property tax <sup>4</sup>
South Dakota.....	\$949.5	\$1.0		\$1.0
Tennessee.....	4,829.2	5.3		5.3
Texas.....	18,347.0	20.3		20.3
Utah.....	1,098.9	1.2	\$1.2	
Vermont.....	432.2	.5		
Virginia.....	5,099.6	5.6		5.6
Washington.....	3,946.3	4.4	4.4	
West Virginia.....	1,628.1	1.8		1.8
Wisconsin.....	5,103.3	5.6	5.6	
Wyoming.....	495.5	.5		.5
Total, 50 States and the District of Columbia.....	315,535.0	348.5	181.9	166.6

<sup>1</sup> The data represent reported assets of all insured commercial banks in each State, June 30, 1971, as reported in "Assets and Liabilities—Commercial and Mutual Savings Banks, June 30, 1971," issued by the Federal Deposit Insurance Corporation for the FDIC, Board of Governors of the Federal Reserve System, and Office of the Comptroller of the Currency, (1971), pp. 14 and 34-101. The figures represent total assets excluding the following items: Cash, reserves, balances with banks, and collection items—Total U.S. Treasury securities, Securities of other U.S. Government agencies and corporations, Obligations of States and subdivisions—35 percent of the reported amount, on the assumption that this is the portion issued by the home State and its subdivisions and would be exempt in Florida. Real estate loans—total, Bank premises, furniture and fixtures, and other assets representing bank premises. Real estate owned other than bank premises.

<sup>2</sup> The assumed effective rate applied to the estimated taxable base for each State is 0.11,043 percent—a rate that would yield \$9,000,000 if applied to the assumed taxable base of \$3,145,400,000 in Florida on June 30, 1971. (This differs from the statutory rate of 0.1 of 1 percent partly because the valuation data are for mid-1971 rather than the Florida assessment date of January 1, 1972; and partly because the actual taxable base would not correspond precisely to categories included in the hypothetical base in the preceding column.)

<sup>3</sup> Several States named in this column have constitutional provisions exempting all intangible personal property or all personal property from property tax.

<sup>4</sup> This column includes several States where the tax on intangible personal property is not enforced or is only rarely enforced.

Senator PROXMIRE. The next two witnesses, representing the American Bankers Association, are Mr. Harry Shuford and Mr. George Le Maistre.

Senator TOWER. I would like to welcome Mr. Shuford, a fellow Texan, here. He is a very public spirited man. He and I served on the board of trustees of Southern Methodist University together and I might note he was the captain of that great SMU football team that played Stanford in 1936.

We will not recite the score of that game.

STATEMENT OF HARRY A. SHUFORD VICE CHAIRMAN, SPECIAL TASK FORCE ON STATE TAXATION, THE AMERICAN BANKERS ASSOCIATION

Mr. SHUFORD. Thank you very much.

Mr. Chairman—

Senator PROXMIRE. May I interrupt to ask what position you played?

Mr. SHUFORD. I played fullback, sir.

Senator PROXMIRE. Did you score in that game?

Mr. SHUFORD. No, sir. [Laughter.]

I will have to say while Senator Tower tried to avoid the score of the game, nor that you ask about it, in all candor it was 7 to 0 in favor of Stanford.

Senator PROXMIRE. You played a great defensive game and that is what you are here to do today.

Mr. SHUFORD. They had a very strong offensive and it looks like we may be on another one just like that.

Mr. Chairman and members of the committee, special thanks to you for permitting us to be here today and a special thanks to Senator Tower. He did mention that we are members of the board of trustees at SMU and he referred to our acquaintance and friendship which I cherish and I must say that I appreciate the fact that—maybe I don't really appreciate it then—but the last time we were together where he was presiding at a meeting in honoring one of our associates he did allude to me and made reference to the fact that when he was a lad I was his hero.

There is a little difference in our age.

We know the committee is aware of the importance of this proposed bill, S. 3652, by virtue of the fact that you have scheduled this hearing here between conventions. We very much appreciate the opportunity to be here.

I have submitted an extensive statement for the record.

Senator PROXMIRE. The entire statement will be printed in full in the record (see p. 50).

Mr. SHUFORD. Thank you, sir.

That being the case I will simply try to summarize it in the interests of time.

I will comment on S. 3652 and Mr. Le Maistre will comment on the two amendments and, of course, you, sir, if you want to have questions in between our statements, we will be glad to answer them then, or we can present both statements together and have all the questions later.

S. 3652 is based on recommendations by the Federal Reserve Board in its report under Public Law 91-156 which, as you know, was submitted to Congress on May 4, 1971.

In its report the Federal Reserve Board made five recommendations. First, intangibles owned by all insured depositories should be exempt from all taxation.

Second, limitations should be placed on the imposition of doing business and similar taxes on out-of-State depositories.

Third, measures should be taken to prevent discrimination between one class of bank and another; for example, between national banks and State-chartered banks or between home State and out-of-State banks and between banks and other business firms.

Fourth, States should be permitted to impose income taxes on the interest on Federal obligations.

Finally, all cash should be considered intangible personal property.

This bill would carry out four of these five recommendations—the one exception is the recommendation to permit State income taxes on the interest on Federal obligations.

This is an issue of great importance and one which we think should be considered separately.

Also, it is not necessary to the resolution of the State tax question.

However, the bill is limited to insured commercial banks and does not cover insured mutual savings banks, insured savings and loan

associations, or insured credit unions, the inclusion of which is recommended by the Board's report.

These institutions would benefit in many States from S. 3652, as they now benefit and as State banks also benefit from the restrictions on taxing national banks in R.S. 6915 because the States do not find it desirable or worth while to impose on them taxes they cannot impose on national banks.

Of course, as far as the American Bankers Association is concerned, we would have no objection to the inclusions of these other institutions in the bill.

The Federal Reserve Board in its report expressed concern over the danger of disintermediation as the result of the taxation of bank-owned intangible personal property.

The Board explained this danger of disintermediation in its report of 1971, in the following language :

An intangibles tax applied to banks and other depository institutions would have a number of adverse economic consequences, depending in magnitude and level and geographic coverage of the tax. In the first instance, the principal effects would be on the functioning of financial intermediaries in gathering savings and allocating funds for productive investment—locally, regionally, and nationally—but ultimately any impediments to this process would have a bearing on the performance of the entire economy.

The process of financial intermediation performed by banks and other depository institutions is particularly vulnerable to an intangibles tax since the duplication of financial assets that is inherent in the flow of savings, first into deposits of those institutions and then into customer loans, would expose savings flowing through intermediaries to an additional layer of taxation not encountered where funds flow directly from savers to ultimate borrowers.

In addition the Board points out the dangers resulting from State taxation discriminating between national and State banks, between home State banks and out-of-State banks, between banks and other competing financial institutions, or between banks and other businesses generally.

The Board made it clear that any State taxation which would result in such disintermediation or such discrimination could have serious adverse effects on the Nation's financial mechanisms and the functions of the Nation's payments system and thereby on the Nation's commerce and on the maintenance of Government itself.

To prevent such disintermediation and discrimination resulting from shortsighted or unwise taxation the Board recommended continued Federal legislation to accomplish three objectives :

First, taxation of bank-owned intangible personal property including cash and currency should be prohibited.

Second, discriminatory taxation should be prohibited.

Third, the imposition of doing business or other taxes on out-of-State banks should be postponed until a fair method of allocating the income of banks between the home State and other States has been established.

We would, of course, expect that most States would agree with these principles.

At the same time, we are aware of the great pressures on States to increase tax revenues, pressures which make it difficult to follow these principles at all times.

Mr. Justice Oliver Wendell Holmes commented on the need for Federal review of State action which might interfere with interstate

commerce. His comments were equally applicable to the closely related money power.

Quoting from Justice Holmes:

I do not think the United States would come to an end if we lost our power to declare an Act of Congress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several states. For one in my place sees how often a local policy prevails with those who are not trained to national views and how often action is taken that embodies what commerce clause was meant to end.

Now I would like to turn to the specific provisions of S. 3652.

S. 3652, would amend the Federal Deposit Insurance Act. It would apply to all commercial banks insured by the Federal Deposit Insurance Corporation, whether national banks or State-chartered banks.

Incidentally, the bill affects only State and local taxation and, of course, has nothing whatever to do with Federal taxation.

Subsection (a), entitled "Authorization for States to Tax National Banks" is based on the permanent amendment in Public Law 91-156 and is intended as an express grant of authority to the States to tax national banks.

Subsection (b) deals with taxation by State or a political subdivision of a State where a bank has a banking office. Paragraph (b) (1) authorizes the continuance of existing taxes if they comply with the restrictions and limitations set forth in subsection (d), which prohibits taxation of bank-owned intangibles and discriminatory taxation of banks.

Paragraph (b) (2) provides that any future taxes which are imposed on banks by their home States or political subdivisions must be imposed on business corporations generally, on a uniform and non-discriminatory basis.

This requirement was intended specifically to require taxation of all business corporations under the same statute, subject to the restrictions of subsection (d), and to rule out any future imposition of taxes applicable only to banks, such as bank share taxes.

It is our view that in the long run the best way to prevent discrimination against banks, national or State, would be to require that banks should be taxed under the general tax statutes applicable to all business corporations and not singled out for special treatment.

Subsection (c) deals with taxation by a State or a jurisdiction where a bank does not have a banking office. It permits such States and political subdivisions to impose taxes on real and tangible personal property in the jurisdiction owned by the bank and payroll taxes on persons employed by the bank in such jurisdiction.

These taxes are also subject to the restrictions and limitations in subsection (d).

In general this follows the out-of-State tax provisions of Public Law 91-156 but it does allow an additional tax, a payroll tax on persons employed in that jurisdiction.

Subsection (d) contains three restrictions relating to the taxation of intangible personal property, discriminatory taxes, and taxation of banks which have banking offices in more than one State or political subdivision.

Paragraph (d) (1) prohibits State taxation of intangible personal property owned by an insured commercial bank.

Paragraph (d) (2) establishes the general policy that no State may engage in taxation which discriminates against any class of insured banks or against insured banks generally.

This policy arises out of the constitutional money power of the Congress under which the Congress has enacted the National Bank Act, the Federal Reserve Act, the Federal Deposit Insurance Act, and other legislation under which our dual banking system carries out the constitutional function of providing the Nation's money supply.

Discriminatory taxation of any class of banks or of banks generally would hamper our dual banking system in performing its function as the Nation's principal money supply and would interfere with the banking system's ability to serve as the Nation's payment mechanism.

Paragraph (d) (2) would establish as the basic test of discrimination whether the allegedly discriminatory tax along with other State and local taxes imposes a higher overall tax burden.

That paragraph recognizes that discrimination may have many causes—the base on which a tax is assessed, the rate at which a tax is assessed, or the manner of assessment or enforcement—any one of which may lead to discrimination in the sense of an overall higher tax burden.

The bill, however, does not prohibit States or localities from using different bases or rates or forms of assessment or enforcement, as long as it can be shown that the overall tax burden on banks does not discriminate against any class of banks or against banks generally.

Paragraph (d) (3) provides that if an insured bank maintains banking offices—defined as offices which receive demand deposits and make commercial loans—in more than one State or political subdivision each separate taxing jurisdiction may impose taxes on the banking offices within its jurisdiction as though they were separate banks.

Now then, turning from S. 3652, I should also like to comment briefly on the related proposals for State taxation of banks contained in H.R. 15656, as reported to the House Committee on Banking and Currency by the Subcommittee on Bank Supervision and Insurance.

This bill is also designed to carry out the three basic policies of the Federal Reserve Board's report which I have already mentioned.

The proposal in H.R. 15656, is designed to carry out the three basic proposals in the Federal Reserve Board's report—protection against taxation of intangibles, protection against discriminatory taxation, and protection against the imposition of doing business or similar taxes on out-of-State banks. In fact, the provisions of the House subcommittee proposal for all practical purposes is virtually identical to S. 3652, as far as taxation of bank-owned intangibles and taxation of out-of-State banks are concerned.

The principal difference between S. 3652 and the House proposal lies in the different provisions relating to discriminatory taxation of home State banks.

Section 204, provides that such a tax must be imposed generally on a nondiscriminatory basis throughout the jurisdiction of the taxing authority but, as you can see, these are very general terms.

In considering whether a tax is nondiscriminatory we believe it is appropriate in the light of the Board's report to consider the factors spelled out in more detail in S. 3652.

The declaration of policy in H.R. 15656, makes it clear that the purpose of the bill is to provide protection against taxation on intangibles or other taxation that would discriminate unfairly against banks generally or against national or State banks.

So it seems clear that this provision, like the provision in S. 3652, is intended to prohibit all taxes which discriminate between one class of bank and another.

It is our view that the more specific provisions of S. 3652 are much more desirable than those of the House proposal.

Accordingly, while we recognize that the House proposal is designed to accomplish the same purposes as S. 3652, protection against taxation of intangibles, protection against discriminatory taxation, and protection against the imposition of doing business or similar taxes on out-of-State banks, we would urge that the committee approve S. 3652. That concludes my statement.

Senator PROXMIRE. Thank you very much. Mr. Le Maistre?

Senator TOWER. Mr. Chairman, I have to go to the floor for consideration of the military procurement bill.

Senator PROXMIRE. Fine. If you have some questions, go right ahead.

Senator TOWER. Could I go out of order?

Senator PROXMIRE. Sure. I will have questions for both gentlemen after Mr. Le Maistre finishes.

Senator TOWER. Thank you, Mr. Chairman, for your forbearance.

What would be the likely outcome of intangibles taxation for banks, in your view? Would the additional burden on financial and intermediaries constrict their function in the economy? Would borrowing tend to move into the commercial paper market, and what would happen to consumer borrowing from banks?

Mr. SHUFORD. Well, Mr. Tower, I think that the imposition of a tax on intangibles would have an effect as explained by Governor Mitchell on the question of intermediation, and I think that there would be a tendency on the part of businesses to do more financing directly in the markets rather than coming into the banks with deposits. This could have an effect on the consumer directly, by reducing the funds available to him from banks.

Senator TOWER. How do you feel generally about the Hunt Commission recommendations, and particularly how do you feel about the movement of thrift institutions toward becoming more like banks, although with perhaps more of a consumer household orientation, while commercial banks become increasingly oriented toward business lending? Is this a desirable direction for financial institutions to move in the future, with generally the same types of powers but serving different types of customers?

Mr. SHUFORD. Well, my own personal view of that, Mr. Chairman, is that it is a desirable move, that they should become more similar in their functions, because I think that it is in the general public interest that there be this competitive aspect.

Senator TOWER. Thank you, Mr. Shuford.

Again I apologize for having to leave, but I have got to get to the floor before Mr. McGovern proposes his amendment.

(The full prepared statement of Mr. Shuford follows:)

STATEMENT OF HARRY A. SHUFORD FOR THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Committee, I am Harry A. Shuford, Chairman of the Trust Committee of the First National Bank in Dallas, and Vice Chairman of the American Bankers Association's Special Task Force on State Taxation.

I appear here today to testify on behalf of the Association in support of continued legislation to regulate State taxation of insured commercial banks. The ABA appreciates your courtesy in scheduling this hearing during the brief interim between conventions. We consider this one of the most vital matters affecting banking before the Congress today and we trust that the Committee and the Senate will act promptly on the matter.

The ABA strongly supports S. 3652, which was introduced by Senator Bennett. This proposal would replace both the interim arrangements provided by Public Law 91-156, which under present law continue until December 31, 1972, and the so-called "permanent amendment" provided by Public Law 91-156, which takes effect on January 1, 1973.

S. 3652 is based on the recommendations made by the Federal Reserve Board in its report under Public Law 91-156, which was submitted to Congress on May 4, 1971, and on the backup material prepared by the Board of Governors and published in December of 1971. It is also consistent with the further report of the Board, which has recently been issued by this Committee, along with the earlier material, as a Committee Print.

In its report the Federal Reserve Board made five recommendations: (1) intangibles owned by all insured depositories should be exempt from all taxation; (2) limitations should be placed on the imposition of "doing business" and similar taxes on out-of-state depositories; (3) measures should be taken to prevent discrimination between one class of bank and another, for example, between national banks and State-chartered banks or between home-State and out-of-State banks, and between banks and other business firms; (4) States should be permitted to impose income taxes on interest on Federal obligations, and (5) all cash should be considered intangible personal property.

S. 3652 would carry out four of these five recommendations—the one exception being the recommendation to permit state income taxes on the interest on Federal obligations, which appears to involve controversial questions not necessary to the resolution of the State tax question. S. 3652, however, is limited to insured commercial banks and does not cover insured mutual savings banks, insured savings and loan associations, or insured credit unions, as the Board's report recommends. These institutions would benefit in many States from S. 3652, as they now benefit, and as State banks now benefit, from the restrictions on taxing national banks in R.S. § 5219, either by parity or equalization statutes or because the States do not find it desirable or worthwhile to impose on them taxes they cannot impose on national banks. We have no objection to the inclusion of these other institutions in S. 3652.

Before discussing the details of these proposals, I should like to present the background of this issue.

S. 3652, as its title states, is a bill "to clarify and regulate the powers of the States to tax commercial banks, to empower the States to tax national banks, to foster and promote the dual banking system by providing for equal State taxation of National and State banks, to promote the interstate flow of moneyed capital and the financial resources of insured banks, to foster and promote interstate and foreign commerce and for other purposes."

The Constitution vests in the Federal Government several functions, including the power to coin money, which together make up the so-called money power. One of the principal responsibilities of the Federal Government arising out of the money power is to provide a medium of exchange for business, the public, and the Government, without which industry and commerce could not be carried on, and the operations of the Government itself would come to a halt. The money stock of the country, as measured by the Federal Reserve Board, consists basically of some \$60 billion of outstanding coinage and currency, and some \$175 billion of demand deposits in commercial banks, against which some 20 billion checks a year are issued, with a total value of more than \$12 trillion. These are the funds that American industry, the Government, and the public use to make their purchases and to pay their bills.

In addition to serving in this way as the Nation's principal payments mechanism, the commercial banking system's \$175 billion of demand deposits, and to a lesser extent the \$250 billion of time deposits in commercial banks, form the mechanism through which the Federal Reserve System carries out its prime function of fostering a flow of credit that will facilitate orderly economic growth within a sound and stable domestic and international economy. The Federal Reserve System expands or contracts the Nation's money stock in order to provide the appropriate flow of credit to meet the Nation's needs primarily by buying or selling Government bonds, which increases or decreases the supply of funds available for lending by commercial banks. Increases or decreases in the available supply of lendable funds can also be stimulated by lowering or raising the discount rates on member bank borrowings from the System. Finally, the Federal Reserve Board can increase or lower the available lendable funds by lowering or raising its reserve requirements for demand and time deposits of member banks, thereby directly releasing or freezing bank funds at the Federal Reserve banks and indirectly increasing or decreasing the bank's available lendable funds in geometric proportions. While these processes work directly on the funds of national banks and State member banks, their influence is quickly felt by nonmember commercial banks and the economy of the entire Nation.

Demand deposits in the Nation's insured banks, in short, serve as the Nation's principal supply of money, and also as the principal mechanism through which the Federal Reserve System carries out its function of providing an even flow of credit to the Nation.

In carrying out these responsibilities, the Federal Government created a system of national banks and authorized the States to tax them within specified limits. This policy began with Section 41 of the National Bank Act, later reenacted as U.S. Revised Statutes § 519 (12 U.S.C. § 548). Throughout the amendments to this law in 1868, 1923, and 1926, the concept of limiting State taxation of national banks to a specified list of taxes remained intact until 1969, when Public Law 91-156 was enacted.

As amended in 1926, section 5219 permitted, in addition to taxing real estate, (1) taxing national bank shares; (2) including dividends derived from national bank shares in the taxable income of the shareholder; (3) taxing national banks on their net income; or (4) taxing national banks according to or measured by their net income. The section also contained a number of provisions designed to prevent discrimination against banks as compared with competing moneyed capital, or other financial institutions or mercantile, manufacturing, and business corporations.

While the limitations on State taxation of national banks contained in section 5219 applied only to national banks, the provision also protected State banks. Obviously if a State should impose substantially higher taxes on State banks than were permitted for national banks under section 5219, all State-chartered banks in that State would be compelled to convert to national bank charters. (While there are a few cases where States imposing share taxes have also imposed income or franchise taxes, which can apply only to State-chartered banks, this is not common and, in any event, such taxes have been at rather low rates. These inequalities in taxation would, incidentally, be terminated by S. 3652.)

During the 1960's sales taxes became increasingly important to the finances of many States. However, they were not among the four taxes which could be imposed on national banks under section 5219 and State governments were therefore unable to impose sales taxes on national banks, except where national banks voluntarily paid them, for example, in Kansas. This resulted in a substantial loss of taxes to the States. In addition, the fact that State banks had to pay sales taxes, while national banks were exempt, resulted in discrimination between national and State-chartered banks which, in some cases, was quite substantial.

In the latter part of the 1960's there was constantly increasing pressure to correct this situation, both in order to provide more taxes for the States, and in order to bring about equality between national and State banks.

Several lawsuits came before the courts, which, in the final analysis, made it clear that any changes in this field would have to be made by the Congress. The First Agricultural National Bank of Berkshire County brought a suit against the Massachusetts State Tax Commission, which resulted in a decision that the federal instrumentalities doctrine embodied in section 5219 no longer obtained and that there was no Constitutional basis for the limitations on State taxation of national banks provided by that section (353 Mass. 172, 229 N.E. 2d 445 (1967)). This case was appealed to the Supreme Court which reversed the Massa-

chusetts Court and held that national banks could not be taxed beyond the bounds permitted in section 5219 (392 U.S. 339 (1968)).

The New York Court of Appeals in *Liberty National Bank and Trust Company v. Buscaglia* also reached the conclusion that the federal instrumentalities doctrine no longer supported the exemption, but reversed itself after the First Agricultural decision, and the Supreme Court continued to maintain its position (21 NY 2d 357, 235 N.E. 2d 101, revd. 23 NY 2d 933, 246 N.E. 2d 361, cert. denied, 396 U.S. 941 (1969)).

A similar result was reached in a case involving the Florida documentary stamp tax. Again the Supreme Court refused to permit taxation beyond the bounds of section 5219 (*Dickinson v. First National Bank of Homestead*, (219 F.Supp 855 (1968), 393 U.S. 409 (1969)).

Legislation was introduced in the 90th Congress in 1968 and additional bills were introduced in the 91st Congress early in 1969 to remedy this situation. Some of these bills merely added sales taxes and a few other specified taxes to the list of taxes which national banks might pay under section 5219; other bills provided more general authority to impose State taxes on national banks.

The legislative process with respect to these bills was long and involved, as this Committee knows. On December 24, 1969, H.R. 7491 was enacted as Public Law 91-156. It established a two-year interim period, lasting until January 1, 1972, during which the home States of national banks could impose any additional nondiscriminatory taxes other than taxes on the banks' intangible personal property.

States were also allowed to impose a limited list of taxes on real estate or on tangible personal property owned by out-of-State national banks or on certain transactions of out-of-State national banks. The Federal Reserve Board was directed to make a study and to report by January 1, 1971, on the problems of taxation of intangible personal property and the problems arising out of "doing business" and similar taxes imposed on out-of-State banks.

When Public Law 91-156 was enacted in 1969, the conferees from both the House and the Senate agreed—

"That their respective committees would give prompt and serious consideration to any recommendations transmitted by the Federal Reserve Board as a result of its study."

The Federal Reserve Board's Report was not filed until May, 1971. This delay prevented the Congress from giving the report the careful consideration promised in December of 1969. On December 22 of last year, consequently, the effective date of the permanent provisions of Public Law 91-156 was delayed until the close of 1972 and the Board was asked to file a supplemental report on taxation of intangibles. This was submitted on June 8, 1972.

The Federal Reserve Board in its report expressed concern over the danger of disintermediation as a result of the taxation of bank-owned intangible personal property. The Federal Reserve Board explained this danger of disintermediation in its May 1971 report in the following paragraphs:

"An intangibles tax applied to banks and other depository institutions would have a number of adverse economic consequences, depending in magnitude on the level and geographic coverage of the tax. In the first instance, the principal effects would be on the functioning of financial intermediaries in gathering savings and allocating funds for productive investment—locally, regionally, and nationally—but ultimately any impediments to this process would have a bearing on the performance of the entire economy.

"The process of financial intermediation performed by banks and other depository institutions is particularly vulnerable to an intangible tax since the duplication of financial assets that is inherent in the flow of savings, first into deposits of those institutions and then into customer loans, would expose savings flowing through intermediaries to an additional layer of taxation not encountered where funds flow directly from savers to ultimate borrowers."

In addition, the Board's report points out the dangers which might result from State taxation discriminating between national and State banks, between home-State banks and out-of-State banks, between banks and other competing financial institutions, or between banks and other businesses generally. The Board made it clear that any State taxation which might result in such disintermediation or in such discrimination could have seriously adverse effects on the Nation's financial mechanisms and the functions of the Nation's payments system and thereby on the Nation's commerce and on the maintenance of Government itself. To prevent such disintermediation and discrimination resulting from shortsighted

or unwise taxation, the Board recommended continued Federal legislation, to accomplish three objectives:

(1) Taxation of bank owned intangible personal property, including cash and currency, should be prohibited;

(2) Discriminatory taxation should be prohibited; and

(3) The imposition of "doing business" or other taxes on out-of-State banks should be postponed until a fair method of allocating the income of banks between the home State and other States has been established.

We would, of course, expect that most States would agree with these principles. As the Board pointed out in its report, there is a long term trend toward abandonment of ad valorem taxes on intangible personal property. Certainly most States would not wish to engage in any form of discriminatory taxation. And generally, most States can be expected to welcome an inflow of capital from out-of-State sources. So there is considerable reason to believe that departures from these principles would be few and far between.

At the same time, we are fully aware of the great pressures on States to increase tax revenues—pressures which may make it difficult to follow these principles at all times. Mr. Justice Oliver Wendell Holmes commented on the need for Federal review of State action which might interfere with interstate commerce.

His comments were equally applicable to the closely related money power:

"I do not think the United States would come to an end if we lost our power to declare an Act of Congress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several States. For one in my place sees how often a local policy prevails with those who are not trained to national views and how often action is taken that embodies what the Commerce Clause was meant to end." (Holmes, "Law and the Court," Collected Legal Papers, 295-296.)

I should now like to turn to the specific provisions of S. 3652.

S. 3652 would amend the Federal Deposit Insurance Act. It would apply to all commercial banks insured by the Federal Deposit Insurance Corporation, whether national banks or State-chartered banks. This is a change from past laws on the subject, beginning with section 41 of the National Bank Act, and R. S. § 5219, which have applied only to national banks, and which have protected State banks only because as a general rule States have not imposed substantially higher taxes on State banks than on national banks. S. 3652 would repeal the National Bank Act provisions (R. S. § 5219; 12 U.S.C. § 548) and would add a new section to the Federal Deposit Insurance Act.

Incidentally, S. 3652 affects only State and local taxes on banks. It has no effect whatever on any Federal taxes.

S. 3652 would carry out the three principal recommendations of the Federal Reserve report as spelled out above, but it would not carry out the Federal Reserve Board's recommendation to permit direct State taxation of interest on Federal obligations.

In the first place, the provision is not necessary to the consideration of State taxes on banks because a franchise tax measured by income, including government bond interest, is available to the States, and accomplishes the same result. In the second place, it seems unnecessary and undesirable to raise, as part of this proposal, the controversial major policy questions involved in changing the tax exemptions for U.S. Government obligations, including such questions as (1) the appropriateness of permitting Government bond interest to be taxed to banks and not to other depositories or other business firms, and (2) the possible connection between a revision of this tax exemption and tax exemption for municipal obligations.

Subsection (a), "Authorization for States to tax National Banks", is based on the "permanent amendment" in Public Law 91-156, and is intended as an express grant of authority to the States to tax national banks.

Subsection (b) deals with taxation by a State or a political subdivision of a State where a bank has a banking office. Paragraph (b) (1) authorizes the continuance of existing taxes, if they comply with the restrictions and limitations set forth in subsection (d), which prohibits taxation of bank-owned intangibles and discriminatory taxation of banks. There is one exception to this grandfather clause—if a tax is imposed on banks and on business corporations generally in the same manner but at higher rates for banks, it may not be continued.

Paragraph (b) (2) provides that any future taxes which are imposed on banks by their home States or political subdivisions must be imposed on business corporations generally on a uniform and nondiscriminatory basis. This require-

ment was intended specifically to require taxation of all business corporations under the same statute, subject to the restrictions of subsection (d), and to rule out any future imposition of taxes applicable only to banks, such as bank share taxes. It is our view that in the long run the best way to prevent discrimination against banks, national or State, would be to require that banks should be taxed under the general tax statutes applicable to all business corporations, not singled out for special treatment.

Subsection (c) deals with taxation by a State or a jurisdiction where a bank does not have a banking office. It permits such States and political subdivisions to impose taxes on real and tangible personal property in the jurisdiction, taxes on the execution delivery, or recordation of documents in the jurisdiction, and payroll taxes on persons employed in such jurisdiction. These taxes are also subject to the restrictions and limitations in subsection (d). In general, this follows the out-of-State tax provisions of Public Law 91-156, the only additional tax authorized being payroll taxes on persons employed in that jurisdiction.

Subsection (d) contains three restrictions, relating to the taxation of intangible personal property, discriminatory taxes, and taxation of banks which have banking offices in more than one State or political subdivision.

Paragraph (d) (1) prohibits State taxation of intangible personal property owned by an insured commercial bank. As later defined in paragraph (e), intangible personal property includes currency, coins, deposits, credit cards and credit card accounts, mortgages, bonds, notes and other obligations, and all documents or other evidence of claims on others. In other words, intangible personal property includes anything which has no intrinsic value—unlike furniture, equipment, and other tangible personal property or the old gold or silver coins. Intangible personal property derives its value from its legal significance, for example, enforceable claims on others, such as notes or mortgages—or U.S. coins and currency, which no longer contain, and no longer are backed up by, precious metals, but derive their value only because they are made legal tender by 31 U.S.C. § 392.

Paragraph (d) (2) establishes the general policy that no State may engage in taxation which discriminates against any class of insured banks or against insured banks generally. This policy arises out of the constitutional money power of the Congress, under which the Congress has enacted the National Bank Act, the Federal Reserve Act, the Federal Deposit Insurance Act, and other legislation under which our dual banking system carries out the constitutional function of providing the Nation's money supply. Discriminatory taxation of any class of banks or of banks generally would hamper our dual banking system in performing its function as our principal money supply, and would interfere with the banking system's ability to serve as our payments mechanism, by means of which interstate and foreign commerce can be carried on.

Paragraph (d) (2) would establish, as the basic test of discrimination, whether the allegedly discriminatory tax, along with other State and local taxes imposes a higher overall tax burden. The possibility of other discrimination such as burdensome or prohibitive taxation of essential bank functions, is recognized, but the basic test is the overall tax burden.

Paragraph (d) (2) recognizes that discrimination may have many causes—the base on which a tax is assessed, the rate at which a tax is assessed, or the manner of assessment or enforcement—any one of which may lead to discrimination in the sense of an overall higher tax burden. The bill, however, does not prohibit States or localities from using different bases or rates or forms of assessment or enforcement, as long as it can be shown that the overall tax burden on banks, after taking all other factors into consideration, such as the application of other State and local taxes, does not discriminate against any class of banks or against banks generally.

We recognize, of course, that comparisons between the different tax burdens imposed on different classes of corporations cannot always be precisely measured. Tax accounting has not reached such a state of perfection as to permit this, and we do not view the bill as requiring perfection. We expect that the legislatures and the courts, acting under and interpreting this provision, would apply it in the light of its basic purpose to protect the banking system against any discriminatory taxation which might prevent it from carrying out its vital constitutional function of providing a monetary system and a payments mechanism for the benefit of industry, the government, and the public.

Paragraph (d) (3) provides that if an insured bank maintains banking offices—defined as offices which receive demand deposits and make commercial loans—in more than one State or political subdivision, each separate taxing

jurisdiction may impose taxes on the banking offices located within its jurisdiction. This provision is of limited significance with respect to State taxation because there are less than a handful of banks which have banking offices in more than one State. This is also true in unit bank States. However, in States which permit branching, Statewide or beyond county lines, this provision could have substantial significance. We recognize that a number of accounting problems will be involved in treating separate banking offices as separate banks, but we believe that if a State wishes to permit its localities to impose taxes on banking offices within them, it can work out a formula which will carry out the purpose and intent of this provision.

I should also like to comment on the related proposal for State taxation of banks contained in H.R. 15656 as reported to the House Committee on Banking and Currency by the Subcommittee on Bank Supervision and Insurance. While this provision is not technically before this Committee, it seems appropriate to comment on it in view of the terms of the announcement of this hearing. For the Committee's convenience, a copy of this proposal is attached to this statement.

The proposal in H.R. 15656 is designed to carry out the three basic policies of the Federal Reserve Board's report: protection against taxation of intangibles; protection against discriminatory taxation; and protection against the imposition of "doing business" or similar taxes on out-of-State banks. In fact, the provisions of the House Subcommittee's proposal, for all practical purposes, is almost identical to S. 3652, as far as taxation of bank-owned intangibles and taxation of out-of-State banks are concerned. The principal difference between S. 3652 and the House proposal lies in the different provisions relating to discriminatory taxation of home State banks.

Section 202 of the House proposal contains a Declaration of Policy emphasizing the desirability of State autonomy in formulating tax policies, but balancing this against the need for carrying out the national goals of fostering an efficient banking system and the free flow of commerce between the States. It stresses the importance of providing protection against taxation of intangible personal property or unfair discrimination against banks or classes of banks. In addition, it points out the desirability of deferring the application of taxes on out-of-State banks measured by income or receipts or other "doing business" taxes until such time as uniform and equitable methods can be developed to determine jurisdiction to tax and to divide the tax base between States.

Section 204 of the House proposal contains provisions relating to the taxation of an insured commercial bank by the State in which its principal office is located. Such a tax must be imposed generally on a nondiscriminatory basis throughout the jurisdiction of the taxing authority. There is a specific prohibition against taxation of intangibles owned by a bank or deposits held by a bank. We understand from the testimony of the Federal Reserve Board in the House and from the Federal Reserve Board's report that this provision is not intended to prohibit continuance of special bank taxes such as bank share taxes, as long as such special taxes do not result in discrimination against banks. The use of the word "generally" is intended, we understand, to prevent arbitrary or capricious taxes rather than to require that taxes be levied on a uniform basis on all corporations alike. We consider that the provision permits continuance of nondiscriminatory bank share taxes and we urge the Committee, if the language of the House proposal is adopted, to make it abundantly clear that the bill would not require repeal of nondiscriminatory special bank taxes levied on banks.

In considering whether a tax is nondiscriminatory we believe it is appropriate, in the light of the Board's testimony and the Board's report to consider the same factors spelled out in more detail in S. 3652. The Declaration of Policy makes it clear that the purpose of the bill is to provide protection against taxes on intangibles or other taxation that would discriminate unfairly against banks generally, or against national or State banks. Accordingly, it seems clear that this provision, like the provision in S. 3652, is intended to prohibit all taxes which discriminate between one class of bank and another, for example, between national banks and State banks, between home State banks and out-of-State banks, or between member banks and nonmember banks. It would also prohibit taxes which discriminate against banks as compared with other business corporations, including other competing financial institutions.

It is our view that the more specific provisions of S. 3652 prohibiting discrimination between classes of banks or against banks are superior to those of the House proposal, though we recognize that the general aims of the two proposals are the same. We also think it is preferable to spell out explicitly the authority for States

to continue to impose nondiscriminatory special taxes such as bank share taxes though again we recognize that the House proposal is intended to reach the same result.

Accordingly, while we recognize that the House proposal is designed to accomplish the same purposes as S. 3652—protection against taxation of intangibles, protection against discriminatory taxation, and protection against the imposition of “doing business” or similar taxes on out-of-State banks—we urge that the Committee approve S. 3652.

The House subcommittee added two provisions to the bill which deserve comment. The first adds to the prohibition against taxation of bank-owned intangibles taxes assessed against the bank on deposits held in the bank. The effect of such a tax is the same as a tax on bank-owned intangibles, and we strongly urge that this provision be added to subsection (d) (1) of the bill.

The second provision requires the Federal Reserve Board to make a study of the problems involved in the imposition of “doing business” and similar taxes on out-of-State banks. Such a study is consistent with the Board’s recommendation based on its earlier study that taxation of out-of-State banks substantially beyond the areas permitted under Public Law 91-156 would be unwise until a statutory method has been devised for allocating the tax base between the various interested States. We would see no objection to such a study, and would consider the Board as well qualified to undertake it as any other agency.

The ABA urges prompt and favorable action by this Committee and the Senate, in view of the limitations on time which will necessarily be imposed by the coming convention and campaigning during this election year. The Committee’s approval of the Board’s recommendations would carry out the commitment undertaken at the time Public Law 91-156 was passed and would be of great assistance to the effective functioning of our banking system and to the free flow of commerce between the States.

Senator PROXMIRE. Mr. Le Maistre?

**STATEMENT OF GEORGE A. Le MAISTRE, VICE CHAIRMAN OF THE GOVERNMENT RELATIONS COUNCIL OF THE AMERICAN BANKERS ASSOCIATION**

MR. LE MAISTRE. Mr. Chairman, my name is George Le Maistre.

I am here as the vice chairman of the Government Relations Council of the American Bankers Association to present the association’s views on amendment 1364 to S. 3652.

I wish to discuss title II of the amendment and then later take up title III. The first involves the cashing of checks drawn on the Treasury of the United States.

The proposed title II provides that no insured bank or insured institution shall refuse to honor any check drawn upon the Treasury of the United States upon presentation of such check by the payee, together with adequate identification, on the ground that such payee does not maintain an account with such bank or institution; or make any charge to such payee for the honoring of such check and it also provides that the Secretary of the Treasury would have authority to prescribe regulations necessary or appropriate to enforce the act.

Banks and other insured institutions which now cash checks for their own account holders would be required to cash checks for any payee upon presentation by a payee with adequate identification.

We assume that the Secretary of the Treasury, when prescribing regulations, will define what constitutes adequate identification. This is not a simple thing to do. For many years, banks experienced great difficulties in determining to the satisfaction of the Treasury Department, what constituted adequate identification of persons presenting savings bonds for payment.

In the cashing of savings bonds, the law requires the bank or other institution acting as paying agent, to bear the loss for cashing a bond for the wrong party unless the Secretary of the Treasury is able to determine from affirmative evidence that the loss was not due to fault or negligence on the part of the agent.

The difficulties experienced by paying agents, including banks, were ameliorated in October 1971, when the Secretary of the Treasury prescribed specific identification procedures which, if followed, would constitute adequate identification for relieving paying agents from liability for losses when bonds are cashed by the wrong persons.

In the annual report of the Secretary of the Treasury, for the fiscal year ending June 30, 1970, (p. 119), indicates that 641 million checks were drawn on the Treasurer, of which about 380 million (p. 105) were paid for social security and veterans benefits.

The Treasurer reports that \$9,300,000 was collected mainly from banking institutions, on 62,000 claims from those liable for checks paid to wrong parties. These claims were in addition to those involving 117,000 substitute checks for \$105.6 million, issued to replace checks that were not received or were lost, stolen, or destroyed.

If financial institutions depart from present procedures in cashing checks drawn on the Treasurer of the United States, it is reasonable to assume that the fraudulent negotiation of such checks would increase significantly and losses would increase beyond the \$9.3 million, reported for 1971.

We believe inercity banks, which can least afford to suffer heavy losses, would be hit the hardest.

If the Congress decides to enact this proposal, it is requested that the practice adopted with respect to the cashing of savings bonds by banks be applied to checks, and that the bill be amended to include a provision relieving banks from any loss incurred in paying checks to the wrong persons if they follow identification procedures prescribed by the Secretary of the Treasury. A suggested provision for this purpose is as follows: Insert the following new section 102 after section 101 of amendment 1364 to S. 3652 (and renumber the subsequent sections.)

Any insured institution honoring a check drawn on the Treasurer of the United States for a payee on the basis of adequate identification, as prescribed by the Secretary of the Treasury, shall be relieved of any liability to the United States for the amount of such check paid to the wrong person, if such payment was made without fault or negligence by the insured institution, and the Secretary of the Treasury is authorized to pay to the drawee, the amount of such check from the funds established by the Government Losses in Shipment Act, as amended, which fund is hereby made available for such purposes.

Mr. Chairman, banks are certainly willing to cooperate in the check-cashing process, provided workable indemnification procedures are provided and losses can be kept to a minimum. In this connection, I would like to cite what banks have been doing in the nearby States of Maryland and Pennsylvania, two of a number of examples of banks meeting their community responsibilities in this matter.

The "Philadelphia plan," developed jointly by the State of Pennsylvania and the Pennsylvania banks, and introduced in Philadelphia last October on an experimental basis, provides that :

1. Selected welfare recipients are assigned to a bank.
2. Their checks are mailed to the bank.

3. They go to the bank within 5 days to pick up their check—if not collected in 5 days, the bank mails the check back to the State.

4. The State provides each recipient with a tamperproof identification card with the recipient's picture, signature, and case number. (If one tries to slice the card to insert a different picture, it comes apart.)

5. A representative from the department of welfare be assigned to the bank to answer questions.

6. The State of Pennsylvania indemnifies the bank against loss, if a loss results after following this procedure.

7. The State of Pennsylvania pay the bank 30 cents for each check handled.

John G. Gelsing, director of the bureau of systems development for the State's welfare operation, said in an interview 2 weeks ago, that the cooperation of the banks has been "just excellent—they have been going out of their way to help us." He added that the program "definitely is a success."

In Maryland, a special committee of the Maryland Bankers Association recently developed a plan to facilitate the cashing of public assistance checks. The plan provides that:

1. All banks in Maryland will provide check-cashing facilities to welfare recipients provided: (a) The State of Maryland issues the recipient a tamperproof identification card, bearing the individual's photograph, signature, case number identical to that on recipient's check, date of issue of the card, and a countersignature by a State official, attesting to the authenticity of the photograph and signature.

(b) The State of Maryland indemnifies the bank against loss provided the check cashed was presented for payment with a State-issued identification card, and provided the teller noted on the back of the check, the issue date shown on the identification card.

The banks of Maryland will make no charge for this service during the testing period. However, the Maryland banking industry reserves the right to reevaluate the cost factors involved at the end of the 6-month experimental program.

The State shall provide for the mailing of welfare checks on Mondays, Tuesdays, or Wednesdays. It is to the advantage of the public assistance recipient who desires to use bank facilities for the cashing of checks not to receive the check on Friday or Monday, which are the 2 busiest days in any bank's operations.

The program's effectiveness will be reviewed with the board of public works, following a 6-month testing period.

Both the Maryland and Philadelphia plans are designed to afford check-cashing facilities for those welfare recipients without accounts, and contain the vital elements of tamperproof identification and indemnification.

In addition, the Maryland banks will provide the State with expert personnel in photo identification systems to aid that State in developing the most effective identification system, at the lowest possible cost.

We feel this same kind of banker-government cooperation should be undertaken at the Federal level before any legislation in this area is enacted and implemented. The American Bankers Association is ready to cooperate.

I think the problem is one of making sure the right person cashes the check and there is no loss associated with the services in cashing the check for the welfare recipient.

Now, as to title III, which deals with the 100-percent insurance for public deposits, we oppose the proposed title III of amendment 1364, which would extend insurance coverage of public deposits to 100 percent. We do not believe that this proposal is in the public interest.

Under the provisions of this title, deposits of public entities in banks and savings and loan associations would be 100-percent insured. The Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation would have the authority to establish limits on the aggregate amount of public funds which the insured institution could legally hold.

We recognize the importance of deposit insurance in providing reasonable protection against loss due to the failure of an insured institution. We do feel, that there is already a satisfactory method for protecting public deposits above the present insurance limit.

In most States, public funds deposited in banks are protected by the pledging of acceptable assets for the amount above the insurance limit, referred to by Governor Mitchell a moment ago, and in the majority of these States, pledging requirements amount to at least 100 percent of these funds.

By the pledging approach, we have what is essentially 100-percent insurance on public accounts. We doubt this legislation will provide a better means of protecting these funds.

Our primary concern is what will happen if pledging requirements no longer exist. Banks would be freed from having to hold an estimated minimum of \$43 billion, which is a little conservative, in securities that are currently pledged against State and local deposits, and at least an additional \$14 billion, pledged against Federal deposits.

The release of pledged securities as a result of 100-percent insurance could have an adverse impact on the Federal, State, and local government securities markets.

In testimony on June 20, 1972, before the House Subcommittee on Bank Supervision and Insurance, Chairman Martin, of the Federal Home Loan Bank Board, expressed this same concern in these words:

It is likely that removal of the insurance limitation on public unit accounts, accompanied by a change in the insurance regulations, would reduce the purchase of both Treasury and municipal obligations by commercial banks.

An adverse impact on demand for these obligations would increase borrowing costs for the Treasury and state and local governments. Given a sizeable amount of such obligations, which are pledged against public unit accounts, an increase in these borrowing costs is likely to be reflected ultimately in an increase in cost levels in the economy generally.

In 1971, testimony before the House Banking and Currency Committee on a similar provision in H.R. 5700, Chairman Burns of the Federal Reserve Board said:

A sizeable portion of the Treasury and municipal obligations held by banks is pledged under the collateral requirements.

For example, according to the latest survey available (1966), over half of the Treasury obligations held by commercial banks were pledged for this purpose; among larger banks, the proportion was even higher.

Extending insurance coverage as proposed in H.R. 5700 would reduce the attractiveness of such securities as investments for the banks, and thus tend to raise borrowing costs for the Federal, state, and local governments.

Banks would have to maintain a certain level of these obligations for liquidity purposes and would want to hold some obligations to help meet their community responsibilities.

However, since such a large amount is held only for pledging, it is questionable whether the present high level would continue without pledging requirements. A drop in demand could raise the cost of borrowing, and therefore have a detrimental effect on government financing, particularly for small municipalities whose obligations are un-rated and generally not traded in the national market.

Supporters of 100-percent insurance coverage state that there would be significant benefits to the socially important housing area.

However, public deposits are not suitable for long term mortgage investment. The experience of commercial banks shows that public funds, even time deposits, are highly volatile.

For example, from the beginning of 1968, until the end of that year, State and local time deposits in banks increased by 20 percent. One year later, at the end of 1969, these time deposits had decreased by 30 percent. Under prudent financial practice, such volatile funds require a large liquidity cushion.

Meeting the enlarged liquidity needs would leave only small amounts available for long term lending.

The Federal Reserve Board has expressed similar reservations. In a letter of June 15, 1972, included in the hearings of the House Subcommittee on Bank Supervision and Insurance, Tynan Smith, Secretary of the Federal Reserve Board, stated that:

The Board is aware that supporters of the proposed legislation anticipate that public benefits may flow from a possible shift of deposits to federally insured savings and loan associations providing additional funds for mortgage lending.

In the Board's judgment, it is unlikely that any resulting benefits would be of such significance as to outweigh the possible adverse effects—on the market for Treasury and municipal obligations. Moreover, diversion of volatile public deposits to savings and loan associations where they would be invested in less liquid form than at commercial banks would raise questions of public financial policy.

Finally, we have always opposed increasing insurance levels to where there would be little reason for a depositor to consider differences in the management and soundness of individual institutions.

The proposed 100-percent insurance for public deposits could be a step toward 100-percent insurance for all depositors. We agree with the reasoning of the President's Commission of Financial Structure and Regulation in rejecting the 100-percent insurance concept.

The Commission recommends more freedom from regulation and more risktaking by financial institutions. If the FDIC or the FSLIC is to be held fully responsible for deposits, an important incentive for good management would be lost since those with large deposits would have no reason to scrutinize the soundness of an institution or its management capabilities.

We feel strongly that the continuance of this incentive is in the public interest.

Title III of amendment 1364 to S. 3652 should be deleted.

Senator PROXMIRE. Thank you very much.

Mr. LE MAISTRE, how do banks get State and local deposits?

Mr. LE MAISTRE. It varies from State to State. In our State, there is no competitive bidding. In some there is.

Senator PROXMIRE. In general, there is not competitive bidding; is that correct? In some States there is, but usually it is not?

Mr. LE MAISTRE. Yes.

Senator PROXMIRE. In your knowledge of commercial banks, have deposits from State and local governments ever been rewarded in terms of political contributions?

Mr. LE MAISTRE. Have they ever what?

Senator PROXMIRE. Are banks rewarded with State and local deposits in return for political contributions?

Mr. LE MAISTRE. I don't know of any. I must say that if you had 100-percent insurance, I would fear that some favorite would get most of the deposits.

Senator PROXMIRE. You don't know of any?

Mr. LE MAISTRE. I don't, no.

Senator PROXMIRE. I think anybody who has run for office knows of many cases where that is true. It seems to be the case.

The Federal Reserve bulletin indicates that commercial banks have \$48 billion in State and local deposits at the end of 1971 out of total commercial bank deposits of \$538 billion. That indicates that State and local deposits represented about 9 percent of total bank deposits.

If each bank had its proportionate share of State and local deposits, each would have about 9 percent of its total deposits from State and local governments. Now, how are State and local deposits actually distributed? Does each bank have the 9-percent figure, or are State and local deposits concentrated in certain banks?

Mr. LE MAISTRE. My experience has been that they are concentrated. Whether by accident or design or convenience—

Senator PROXMIRE. That concentration certainly is the case. If a bank had more than 50 percent of its deposits from State and local governments, would you consider this a sound banking practice?

Mr. LE MAISTRE. No, sir. I think that type of deposit moves in and out too fast.

Senator PROXMIRE. Do you think it is fair and equitable for a bank to have more than 50 percent of its money in State and local deposits? Shouldn't the public money be distributed more broadly from the standpoint of equity and fairness, in view of the fact this is a benefit to the bank to have deposits that they always want deposits from State and local governments?

Mr. LE MAISTRE. That is true, but if you are looking only at the equitable distribution as between the banks, obviously it is fair for bank A to have as much as bank B relative to size.

Senator PROXMIRE. Relative to size. That is fine. But if you concentrate in a very few banks, it would hardly be fair and equitable, isn't that right, to the other banks?

Mr. LE MAISTRE. There might be other considerations than just trying to be fair to the banks.

Senator PROXMIRE. You are not doing it by competitive bidding.

MR. LE MAISTRE. Some States do have competitive bidding. Some banks simply refuse to take public deposits because they do not want to be hampered with the need for pledging public securities.

SENATOR PROXMIRE. I have a table prepared by the FDIC showing the banks with the highest ratio of State and public deposits. The highest is 79.29 percent. The ratio of the hundredth bank is 36.95 percent.

There are 100 banks in the country with more than 36.9 percent of their money in State and local deposits. There are 18 banks with more than 50 percent of their deposits in State and local governments.

Moreover, the State-by-State distribution of these hundred favored banks is quite interesting; 49 of them are located in just six States. Texas leads the Nation with 10, followed by Florida with nine, Kansas with nine, Alabama with eight, Louisiana with seven, and Missouri with six.

How do you explain this excessive concentration of public deposits in these few States, and particularly the States of Texas and Alabama where you gentlemen come from?

MR. LE MAISTRE. I can explain to some extent the situation in Alabama. One of those banks I know is a small bank which just opened with some \$5 million deposits, \$3 million of which was State funds. They simply invested its \$3 million in securities which it pledged and operated as a \$2 million bank with a \$3 million deposit alongside.

SENATOR PROXMIRE. Is that a sound banking practice?

MR. LE MAISTRE. It didn't hurt anything.

SENATOR PROXMIRE. You just testified if more than 50 percent were from State and local governments, it was not sound.

MR. LE MAISTRE. I prefer not to have it that way. I don't criticize that bank for not doing it because I don't think he took any risk. He put 100 percent of securities up for the \$3 million of deposits.

SENATOR PROXMIRE. That is a pretty heavy subsidy of that bank, isn't it?

MR. LE MAISTRE. I have to agree it is.

SENATOR PROXMIRE. Would you like to comment on that, Mr. Shuford?

MR. SHUFORD. I would be pleased to, Mr. Proxmire.

In Texas, we do take public deposits on a competitive bidding basis, and it is competitive, very competitive. It is difficult to figure what rates should be paid, and my experience is that a lot of banks are not interested in these deposits, and in one sense it is sort of a public service to take them on. So I would say in Texas that—

SENATOR PROXMIRE. Is that by law? Are they strictly allocated on the basis of low bidder or the high bidder, whichever it is?

MR. SHUFORD. Yes, sir; I can't speak about all States or all localities. There are different statutes and different laws with respect to different localities. For instance, in Dallas—

SENATOR PROXMIRE. When you say competitive bidding, it isn't necessarily a statewide situation?

MR. SHUFORD. No; local school districts, city funds, local school districts. These sort of funds.

Now, I believe as far as the State funds are concerned, there is no competitive bidding, I believe, for State funds. But for local funds, it is a competitive, a very competitive thing.

Senator PROXMIRE. Let's take the People's Bank of Clio, Ala., which had 59.87 percent of its deposits in the form of State and local deposits at the end of 1970. This percentage was the eighth highest in the Nation. Clio happens to be Gov. George Wallace's hometown. Do you think this factor has anything to do with the Clio bank receiving so much money from the State of Alabama?

Mr. LE MAISTRE. I would have to say in all candor I think it does. [Laughter.] However, that is not his hometown now. He has an interest—not a financial interest, but he is personally interested in that town. I am sure that he probably was instrumental in helping them get that State deposit.

I would like to point out to you that they have an equal amount of securities pledged to secure the deposit.

Senator PROXMIRE. Yes, but it is not by competitive bidding, is it? It is an enormous advantage to that bank as compared with other banks. It is not a sound banking practice on the basis of your earlier testimony.

My amendment would give the FDIC the authority to limit the aggregate amount, give them the discretion to limit the amount of State and local funds that may be deposited in any one bank on the basis of the size of the bank.

In view of the rather clear evidence that certain banks have been singled out for favoritism, don't you think the authority to limit State and local deposits would be a desirable reform? Wouldn't such a provision benefit the vast majority of banks, many of which have not received their fair share?

Mr. LE MAISTRE. No, sir; I don't feel that this is a problem.

Let me point out this bank of Clio, which you mentioned, is a very small bank. While it has 59 percent of its deposits in public funds, they are an infinitesimal part of the public deposit in the State. So the others are probably placed in accordance with good management principle. They are probably placed in good sound banks.

I am not discrediting that bank. I know nothing about its operation.

Senator PROXMIRE. There are eight banks in Alabama alone that have 37 percent of their deposits or more in State and local governments.

Mr. LE MAISTRE. Some of that is due to the convenience of depositing certain funds which might be disbursed in Montgomery—in the city of Montgomery. It is easier to work with the local bank.

Senator PROXMIRE. And some of it is, as you admitted, due to good connections?

Mr. LE MAISTRE. Beg pardon?

Senator PROXMIRE. Good connections in the Government?

Mr. LE MAISTRE. I would say it wouldn't hurt anything.

Senator PROXMIRE. Mr. Shuford, as we pointed out earlier in our colloquy with Governor Mitchell, banks pay only 10 percent of their net income in taxes to the State and local governments, compared to nonfinancial institutions which pay 44 percent. Do you think that is equitable?

Mr. SHUFORD. Mr. Proxmire, on that, let me say I heard the discussion, of course, and I would say if those were all of the fact, and without knowing more, that it certainly doesn't sound that way.

But as far as I am concerned, I am not prepared to answer those questions with respect to the statistics.

Senator PROXMIRE. I think that is a proper answer, and this by itself may not be enough. But isn't this suggestive that it doesn't seem to be necessary for Congress to single out commercial banks and no other industry with respect to State taxation if they are not very heavily taxed now? In fact, they seem to be undertaxed, if anything.

What is so special about the banking industry to justify this favored treatment that this bill would provide for them?

Mr. SHUFORD. Let me say again I do appreciate your observation that we need to know more about the particular situation.

Speaking for Texas, we did have a study made, not for this purpose but in connection with some legislation in Texas. We had a study made by Norman Register, onetime head of the National Association of Taxing Authorities, and it was established there that the banks in some 13 or 14 just selected cities, because of the people and all of the larger cities, that they were either one, two, or three largest taxpayer in the community.

So what I am saying is that as far as Texas is concerned—I believe especially in the larger cities which are the ones we surveyed, and I would think it would be true throughout, since we do pay on a share-tax basis—that the taxes on banks in Texas is disproportionately large with respect—

Senator PROXMIRE. That may well be. When you give national figures, you may have some States in which it is considerably better.

Mr. SHUFORD. Yes.

Senator PROXMIRE. But I am asking you as a representative of the American Bankers Association for the whole country.

Mr. SHUFORD. Yes, sir.

Senator PROXMIRE. These appear to be the national figures. We derived them from the Federal Reserve Board's own documentation which I put in the record.

Mr. SHUFORD. There is something which needs further study there and I am sure the ABA would be pleased to look into that for you, Mr. Proxmire.

There is something which needs to be studied, especially in terms of what we are paying in Texas.

Senator PROXMIRE. Do you regard commercial banks as Federal instrumentalities?

Mr. SHUFORD. Did you say national or Federal?

Senator PROXMIRE. Federal.

Mr. SHUFORD. I certainly think they are at least—have a Federal influence. I think they are sort of like the Federal Reserve System, but not as much so; quasi-public in their function to the extent that they are a part of the monetary system.

Senator PROXMIRE. Well, now, since at least it is quasi and they are a part of the Federal monetary system, would you favor Federal legislation requiring banks to invest a certain percent of their assets in socially useful loans such as low-income housing?

Mr. SHUFORD. No, sir.

Senator PROXMIRE. You would not?

Mr. SHUFORD. I would not. I think they are participating in socially useful loans, participating more and more, and I think we should

participate in these loans, but I don't think Federal legislation on a national basis would be in the interests of the public or the depositors in the banks.

Senator PROXMIRE. Now, is this consistent? You favor legislation which would protect them against State legislatures imposing State taxation which you regard as discriminatory or unfair, but then you deny the right of the Government to use these so-called quasi-public or quasi-Federal instrumentalities to achieve certain social purposes.

Mr. SHUFORD. I think that they should—excuse me—

Senator PROXMIRE. Don't you want it both ways?

Mr. SHUFORD. I don't think so, sir. I think that banks should participate in these socially welfare loans and socially useful purposes. I think that they are. But I think that it would not be in the general public interest to have a Federal law which would provide a specific or certain amounts that each bank across the country should participate in these needs.

Senator PROXMIRE. It seems to me if banks want to be treated as free enterprise and take their lumps and get their awards and rewards they shouldn't come to the Federal Government saying they want protection against taxation which no other business is getting or asking for.

Mr. SHUFORD. Mr. Proxmire, frankly and honestly, I think banks are different from other institutions in several respects in this area.

I think that they are an important part of the payments mechanism and they provide the bulk of the money supply and, to that extent, and to the extent that the public might be injured in this area of disintermediation, that they do need protection in this regard.

Senator PROXMIRE. Why can we not trust the State legislatures? They would not overtax banks without doing serious damage to the economy. There has been no showing that any State has gotten out of line.

Where is the real danger that we are being asked to save them against? What evidence is there?

Mr. SHUFORD. I do not know we have any evidence at this time. Section 5219 has protected national banks directly, and State banks and savings and loan associations indirectly, ever since 1864. We are talking about something really, in the future. But banks—in addition to having this important role to play in the economy and in addition to this matter of disintermediation which you and the Governor discussed so well, and I will not repeat—banks also are highly vulnerable in this area. As you all are aware, we are required to publish our figures regularly which is not true of business corporations or individuals locally. Our experience in Texas at least—this is about the only place I can speak of, but I think it is true in other areas which has been indicated in some of the discussion this morning—is that we are highly visible. In our State, on the share-tax basis, we are paying on the basis of an intangible sort of tax and we do have an intangible tax in Texas.

But it is not in force. Very little income comes in by virtue of the intangible tax on business corporations and individuals. So, I say here again, banks are different. They have this high visibility. Another point that was well made by Justice Holmes in the quotation I read earlier. In this area we do need to be aware—and I think we all are aware—that the States are under pressure to gather more taxation and

banks are visible and while there is a tendency, has been a tendency away from intangible taxes, if they are not precluded, then I think that the States very well will move in and probably would move in, into this area which will, in my opinion, not be in the public interest because of disintermediation.

Senator PROXMIRE. Before I yield to Senator Brock, with the unanimous consent, I will place in the record, a table which documents our discussion on concentration of public deposits.

(The information follows:)

THE 100 INSURED COMMERCIAL BANKS WITH THE LARGEST RATIOS OF TOTAL STATE AND LOCAL GOVERNMENT DEPOSITS TO TOTAL DEPOSITS, DECEMBER 1971

[In thousands of dollars]

Bank name	Total deposits	Total State and local government deposits	Ratio
The Farmers Bank & Capitol Trust Co., Frankfort, Ky.....	145,840	103,911	71.25
Civic Plaza National Bank of Kansas City, Kansas City, Mo.....	22,891	14,522	63.43
Bank of Newport News, Newport News, Va.....	7,865	4,912	62.45
Merritt Island Bank, Merritt Island, Fla.....	7,624	4,718	61.88
The Peoples Bank, Clio, Ala.....	4,705	2,905	61.74
Capitol Bank & Trust Co., Boston, Mass.....	59,258	34,677	58.51
Harbor National Bank of Boston.....	41,113	23,894	58.11
Main Bank & Trust, San Antonio, Tex.....	91,953	52,868	57.49
First Wisconsin National Bank of Mequon, Mequon, Wis.....	7,394	4,195	56.73
Citizens Bank of Las Cruces, Las Cruces, N. Mex.....	9,457	5,289	55.92
Bank of Hillsboro, Hillsboro, Mo.....	9,527	5,086	53.38
Clayton Bank, Clayton, Mo.....	83,948	43,962	52.36
First State Bank of San Diego, San Diego, Tex.....	8,632	4,393	50.89
American National Bank of Austin, Austin, Tex.....	200,139	100,895	50.41
Iraan State Bank, Iraan, Tex.....	2,200	1,105	50.22
Fairfield State Bank, Fairfield, N.J.....	3,919	1,964	50.11
Suburban West State Bank, Goddard, Kans.....	1,566	782	49.93
First State Bank, Campbell, Ala.....	4,618	2,287	49.52
First National Bank of Lakeland, Lakeland, Ohio.....	26,951	13,313	49.39
First State Bank of Winter Garden, Winter Garden, Fla.....	4,814	2,365	49.12
First Security Bank of Helena, Helena, Mont.....	8,839	4,337	49.06
First National Bank of Warren, Warren, Mich.....	39,268	18,742	47.72
Peoples Bank Charlotte Amalie, V.I.....	10,492	5,000	47.65
First State Bank, Smiths, Ala.....	1,178	561	47.62
First State Bank of McKinney, McKinney, Tex.....	3,254	1,541	47.35
De Soto State Bank, De Soto, Kans.....	6,001	2,820	46.99
Peoples Bank & Trust, Chalmette, La.....	19,999	9,373	46.86
Northwestern National Bank of Hastings, Hastings, Minn.....	31,111	14,485	46.55
Colfax Banking Co., Colfax, La.....	3,062	1,421	46.45
Nevada State Bank, Las Vegas, Nev.....	67,147	30,523	45.45
State Bank of Albany, Albany, N.Y.....	686,440	311,313	45.35
Randolph Field National Bank, Universal City, Tex.....	17,846	8,036	45.02
Fredonia State Bank, Nacogdoches, Tex.....	11,849	5,333	45.00
Carabell Bank, Carabell, Fla.....	2,385	1,060	44.44
Jefferson Bank & Trust, Jefferson Parish, La.....	23,851	10,570	44.32
First State Bank of Portis, Portis, Tex.....	560	248	44.28
Bank of Pleasant Hill, Pleasant Hill, La.....	2,215	972	43.88
Seminole State Bank, Seminole, Tex.....	14,809	6,436	43.46
Texas State Bank, Austin, Tex.....	35,602	15,450	43.39
Oklahoma National Bank of Norman, Norman, Okla.....	8,523	3,683	43.21
Eastern Washington Bank, Moses Lake, Wash.....	2,541	1,095	43.09
Burlington Bank & Trust, Burlington, Mass.....	14,780	6,342	42.90
Community Bank of Boca Raton, Boca Raton, Fla.....	4,429	1,900	42.89
State Bank of Stanley, Stanley, Kans.....	6,750	2,868	42.48
Deer Park Bank, Deer Park, Tex.....	16,768	7,123	42.47
Augarland State Bank, Jeannett, La.....	2,061	873	42.35
Watkins Banking Co., Faunsdale, Ala.....	782	328	41.94
Mercantile Bank & Trust, Gretna, La.....	14,376	6,029	41.93
First American Bank of North Palm Beach, Palm Beach, Fla.....	44,561	18,641	41.83
Colonial Bank, New Orleans, La.....	27,668	11,559	41.77
Bank of Commerce & Trust Co., Francisville, La.....	9,037	3,744	41.42
State Bank of Spring Hill, Spring Hill, Kans.....	5,416	2,223	41.04
State Bank & Trust Co., San Marcos, Tex.....	19,738	8,098	41.02
Bank of New Mexico, Albuquerque, N. Mex.....	122,031	50,050	41.01
United State Bank of Seminole, Sanford, Fla.....	9,808	4,018	40.96
First Mustang State Bank, Mustang, Okla.....	2,417	989	40.91
Alaska State Bank, Anchorage, Alaska.....	62,161	25,372	40.81
United National Bank, Cocoa Beach, Fla.....	14,257	5,796	40.65
Summit County Bank, Fisco, Colo.....	4,023	1,630	40.51
Peoples Bank & Trust, Anchorage, Alaska.....	10,964	4,421	40.32
University Bank of Carbondale, Carbondale, Ill.....	13,523	5,449	40.29
Matanuska Valley Bank, Anchorage, Alaska.....	53,176	21,426	40.29

THE 100 INSURED COMMERCIAL BANKS WITH THE LARGEST RATIOS OF TOTAL STATE AND LOCAL GOVERNMENT DEPOSITS TO TOTAL DEPOSITS, DECEMBER 1971—Continued

[In thousands of dollars]

Bank name	Total deposits	Total State and local government deposits	Ratio
The Community Bank, Lake Oswego, Oreg.	7,869	3,165	40.22
Bank of Hawthorne, Hawthorne, Fla.	4,300	1,696	39.44
Metropolitan Bank of Syracuse, Syracuse, N.Y.	48,727	19,211	39.42
The First National Bank of Olathe, Olathe, Kans.	21,721	8,547	39.34
Western Bank, Billings, Mont.	1,363	536	39.32
Lyon County State Bank, Emporia, Kans.	9,947	3,906	39.26
First Security Bank & Trust, Carrollton	9,895	3,884	39.25
Charlotte County National Bank, Port Charlotte, Fla.	2,513	977	38.87
The First National Bank of Jacksonville, Jacksonville, Fla.	14,520	5,642	38.85
The Central Trust Bank, Jefferson City, Mo.	125,277	48,599	38.79
The First National Bank of Anchorage, Anchorage, Alaska	194,076	75,242	38.76
Bank of Northern Utah, Clearfield, Utah	1,898	734	38.67
Citizens Bank of Eufaula, Eufaula, Ala.	9,079	3,501	38.56
Rocks County State Bank, Woodston, Kans.	1,242	478	38.48
First Bank & Trust, Bryan, Tex.	51,420	19,756	38.42
Baton Rouge Bank & Trust Co, Baton Rouge, La.	28,007	10,740	38.34
City & County Bank of Powell, Powell, Tenn.	2,388	915	38.31
First National Bank of Stillwater, Stillwater, Minn.	35,992	13,750	38.20
Baker Bank & Trust Co, Baker, La.	22,538	8,587	38.10
Midtown National Bank, Pueblo, Colo.	4,693	1,784	38.01
Citizens Bank of Edinburg, Edinburg, Ill.	1,762	669	37.96
McCall State Bank, McCall, S.C.	2,285	866	37.89
Merchants Bank, Bolton, Bolton, Miss.	2,047	774	37.81
Lyndon State Bank, Lyndon, Kans.	5,692	2,140	37.59
First National Bank of Stafford, Stafford, Tex.	11,061	4,156	37.57
First National Bank Newport, Newport, N.H.	3,554	1,334	37.53
State Bank of Kingsville, Kingsville, Tex.	11,897	4,462	37.50
The Suffolk County National Bank, Riverhead, N.Y.	43,700	16,297	37.29
Imperial Bank of Lakeland, Lakeland, Fla.	19,778	7,370	37.26
Custer County State Bank, Arapaho, Okla.	1,185	441	37.21
First National Bank in Grand Prairie, Grand Prairie, Tex.	17,810	6,625	37.19
Glen State Bank of Minnetonka, Minnetonka, Minn.	6,964	2,588	37.16
State Bank of Belmont, Belmont, N.Y.	2,271	843	37.12
First National Bank of Dexter, Dexter, N.Y.	4,153	1,541	37.10
The First National Bank of Clayton, Clayton, Mo.	103,131	38,053	36.89
Hamilton Bank, Hamilton Township, N.J.	8,488	3,110	36.63
Gulf Coast Bank, Abbeville, La.	3,670	1,340	36.51
Bank of Springville, Springville, Ala.	2,740	999	36.45

Distribution of 100 banks with highest percentage of State and local deposits by State, 1971

State	Number of banks	State	Number of banks
Texas	17	Kentucky	1
Florida	11	Michigan	1
Louisiana	11	Mississippi	1
Kansas	8	Nevada	1
Alabama	6	New Hampshire	1
Missouri	5	Ohio	1
New York	5	Oregon	1
Alaska	4	South Carolina	1
Massachusetts	3	Tennessee	1
Minnesota	3	Utah	1
Oklahoma	3	Virgin Islands	1
Colorado	2	Virginia	1
Illinois	2	Washington	1
Montana	2	Wisconsin	1
New Jersey	2		
New Mexico	2	Total	100

Senator PROXMIRE. Senator Brock?

Senator BROCK. I have several areas of inquiry.

First, on this political contribution question which the Senator raised, I would share his concern about the possibility of the misuse of the power of placement of local funds, State funds, in given institutions.

There has been abuse of that power and it is a matter of some concern, but I think it is something that is subject to rectifying by regulation. In the first place, it is my experience that banks are probably the worst contributors in the political process in this country. [Laughter.]

There are one or two in my own State that are very actively involved in politics. Most are not, and most are terrified of the whole process. Whether or not they are preserving their own assets or not, I do not know.

Senator PROXMIRE. I think you may have a different view as you move up in seniority on this committee. [Laughter.]

Senator BROCK. I was on the House committee for 8 years, and was No. 4 over there and did not feel a great deal of the impact of seniority. Maybe I am unique.

Maybe I do not control the allocation of deposits in local banks. Maybe that is why.

Senator PROXMIRE. It depends on how heavy your contributions are. When you just get very little, the amount which you get from any one group seems very high. When you get a great deal—

Senator BROCK. I defer to your judgment and experience on that matter. [Laughter.]

Senator PROXMIRE. I would sure like to trade contributions with you, Bill, anytime.

Senator BROCK. Maybe we can do it.

On the matter of these deposits, according to Senator Proxmire's figures, only 18 banks have over 50 percent of their deposits in the form of public deposits.

If I remember correctly, that is approximately one-tenth of 1 percent of the banks of this country.

Now, if that is true, I wonder if we really need Federal legislation. I wonder if, in fact, there is some stagnation, there is some impingement upon a bank's flexibility and responsiveness by being too heavily involved in public funds, if that is not something the FDIC could control or the Federal Reserve Board could respond to by regulation.

I cannot see applying this meat-ax to 99.9 percent of the banks that do not have the problem. My one-tenth of 1 percent is right then. There is a problem with S. & L.'s.

The Home Loan Bank Board has a regulation which says they cannot pledge public funds so they have some inhibition against that kind of investment, but that, too, is subject, I think to correction and that the Home Loan Bank Board as far as I am concerned could—perhaps with legislation—simply say, that they could use these deposits with pledging for these purposes.

Mr. LE MAISTRE. To the extent they do not lose their tax preference, certainly they could be authorized to pledge securities for public deposits.

Senator BROCK. All right, now, net us talk about tax preference. If we are going to require banks to get into "socially advantageous" fields, at least from the public policy point of view, or the Federal Government's point of view, if we are in effect, going to ask them to compete with S. & L.'s, or vice versa, it seems to me, they should pay the same amount of taxation.

It is not so today. There is a tax preference in America that is with savings and loans, not the other way around, am I correct?

Mr. SHUFORD. I think so.

Mr. LE MAISTRE. We would hate to see the amendment go in without some equalization of the taxation.

Senator BROCK. What you are asking banks to do is asking them to compete without giving them a chance to compete.

Now, there are justifications for using tax advantage in order to achieve a social purpose, but to require the social purpose without commensurate recompense, then I think that is unfair.

Let me go to the heart of title III of the amendment—this 100 percent guarantee. The thing that bothers me about it is that you have \$43 billion worth of State deposits offset by a pledge, is that correct?

Now, that means in effect, you have got \$43 billion worth of State and local bonds—\$57 billion worth of State, local, and Federal securities used as pledge.

If you removed that obligation, that pledging obligation, and substituted a Federal guaranty, then do you not seriously jeopardize that market for those securities, local government securities, and the like?

Mr. LE MAISTRE. It is our opinion that you would. Because there is certainly no other reason for holding those securities except to pledge against the public funds.

Senator BROCK. Then are we not robbing Peter to pay Paul? Are we not saying, we want money used for social purposes such as housing, we are going to free it, but we have to raise the cost of local government in financing its capital program?

Mr. LE MAISTRE. Yes. I think that is true. As a matter of fact, if you are operating in a town whose credit is not triple A, you may buy the town's bonds just to secure the deposit of the town's funds.

You have no other reason for buying them and you certainly would not buy them if you did not have to use them for pledges. That town would have a difficult time selling its securities.

Senator BROCK. Besides that, there is a very large number of small towns, communities who would find it virtually impossible, if not totally so, to finance a capital financing program, sewage, streets, so on.

That is the nub of the question. It is not a matter of requiring the banks to meet a certain social objective. It is a matter of whether or not in meeting that objective, we do not deny the achievement of other social purposes. This Congress, right now, is debating revenue sharing.

We hope to pass it within a very short period of time, maybe a week or so. If we are going to try to restore to local government a response capacity, a resource base by which they can cope with the needs of their citizens and then take away their responsiveness, we again are defeating our own purpose and I think that is somewhat contradictory.

In the last analysis, what you are saying is that title II of the proposed amendment is subject to modification, and correction, but title III is not, that it—it is in no way acceptable and cannot be modified to be acceptable?

Mr. LE MAISTRE. Let us say, we would certainly not like to see it adopted as it is. I suppose there could be some modification to equalize interest rates and dividend rates and equalize taxation in the various institutions and achieve some equality.

Senator BROCK. I am talking about the amendment now, not the bill.

Mr. LE MAISTRE. I am speaking of the amendment which authorizes public deposits in savings and loan institutions, for instance.

Senator BROCK. All right. What you are saying, is that they are not allowed to pay a higher rate on those and that has to be adjusted, too?

Mr. LE MAISTRE. One of the things that bothers us if there is this political influence in placing accounts at a place where they otherwise would not go, does not giving 100 percent insurance to that account simply take the politician off the hook?

He is never responsible for having done it if there is no risk in it. It seems to me the one safeguard we have now is that he has to select an institution which is responsible.

Senator BROCK. It may send shudders up the spines of bankers studying these proposals but I would like to see an interest rate paid on those average deposits if there is some stability in them.

Mr. LE MAISTRE. There is an interest rate paid in many cases.

Senator BROCK. There is not in many others. Frankly, I think that would solve the problem more quickly than anything of this sort. You may not want to pursue that one.

That is all I have, Mr. Chairman.

I thank you for your testimony.

The CHAIRMAN. Well, I am sorry I have not been here to hear the statements of you gentlemen. I have been fairly well briefed on this. I also have read a good part of your statement that you filed.

I had some questions but I understand that they have been asked.

But, just for my own curiosity, I want to ask you a few questions about cashing checks drawn on the Treasury of the United States.

Your opposition to being required to cash those checks does not mean that your banks would not cash the checks when proper identification is made? You just do that as a matter of practice?

I am thinking primarily about the social security and veteran's benefits checks, things of that kind by many people who undoubtedly have no bank accounts and have to rely on some bank or some merchant or somebody to cash them.

I just assumed that the banks will cash them. I mean it is a matter of practice, when they know the person with whom they are dealing. There will be no problem there, will there?

Mr. LE MAISTRE. No, sir. Our interest is in working out some way of identifying the man.

I have an example just a couple of months ago of a very old man dying on the day his check, his social security check arrived. His son had the same name. Without intending to defraud anybody the son took the check to the bank and cashed it, using his same name and his own identification.

Obviously, he was not entitled to it. He thought he was and there was not any fraud. If he had been inclined to take that money, there is nothing the bank could have done to protect itself. The man with that name and that identification presented himself.

Senator BROCK. Mr. Chairman, if I might.

The CHAIRMAN. Yes.

Senator BROCK. I might point out we have just passed legislation which would allow social security checks to be sent direct to the financial institution which frankly would save the Government an awful lot

of money and it would save the banks an awful lot of lost funds due to fraud.

You mentioned \$9.3 million worth of losses. There is a huge amount of theft in this country of these Government checks through the mails and it is not only the theft without the system, but within the system itself. We have had examples of theft within the postal system, social security checks and the like.

If one check were sent to a bank in my own hometown of Chattanooga, for credit to the account of the individuals involved, you would have no loss. It would be a far, far preferable system as far as I am concerned.

We have active legislation. It has not become law but we have passed it, enabling that; and I would certainly encourage the pursuit of that particular proof.

Mr. LE MAISTRE. It is working very well in Philadelphia. It is an excellent plan they think.

The CHAIRMAN. I think it would also be a protection to the person. I know nothing about this except as I have read in the papers that in some places, people watch for the postman on the day of the month that the social security check is to be delivered or whatever the check might be in order to steal it.

Senator BROCK. That is right.

The CHAIRMAN. Out of the mailbox. Of course, this would be getting around that.

Mr. LE MAISTRE. Sure.

The CHAIRMAN. Well, thank you very much. We certainly are indebted to both of you. Anytime we—you have any thoughts to suggest to us, let us have them.

Mr. LE MAISTRE. Thank you very much.

Mr. SHUFORD. Thank you very much.

(The statement of Mr. Le Maistre and additional material from the American Bankers Association are reprinted as follows:)

STATEMENT OF GEORGE A. LE MAISTRE ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Committee, my name is George A. LeMaistre, chairman and chief executive officer of the City National Bank of Tuscaloosa, Alabama. I am Vice Chairman of the Government Relations Council of the American Bankers Association and appear here to present the views of the Association on Amendment 1364 to S. 3652 dealing with the cashing of U.S. Government checks, and Full Deposit Insurance for Public Units. I will first testify on Title II of the Amendment and then on Title III.

CASHING OF CHECKS DRAWN ON THE TREASURER OF THE UNITED STATES

(Title II of Amendment 1364 to S. 3652)

The proposed Title II of Amendment 1364 provides that "no insured bank or insured institution shall refuse to honor any check drawn upon the Treasury of the United States upon presentation of such check by the payee, together with adequate identification, on the ground that such payee does not maintain an account with such bank or institution;" or "make any charge to such payee for the honoring of such check." The Secretary of the Treasury would have authority to prescribe regulations necessary or appropriate to enforce the Act.

Banks and other insured institutions which cash checks for their own account-holders would be required to cash checks for any payee upon presentation by a payee with adequate identification. We assume that the Secretary of the Treasury, when prescribing regulations, will define what constitutes "adequate iden-

tification." This is not a simple thing to do. For many years banks experienced great difficulties in determining to the satisfaction of the Treasury Department what constituted adequate identification of persons presenting savings bonds for payment.

In the cashing of savings bonds the law requires the bank or other institution acting as paying agent, to bear the loss for cashing a bond for the wrong party unless the Secretary of the Treasury is able to determine from affirmative evidence that the loss was not due to fault or negligence on the part of the agent. The difficulties experienced by paying agents, including banks, were ameliorated in October, 1971, when the Secretary of the Treasury prescribed specific identification procedures which, if followed, would constitute adequate identification for relieving paying agents from liability for losses when bonds are cashed by the wrong persons.

The annual report of the Secretary of the Treasury for the fiscal year ending June 30, 1971 (page 119), indicates that 641 million checks were drawn on the Treasurer, of which about 380 million (page 105) were paid for social security and veterans benefits. The Treasurer reports that \$9.3 million was collected, mainly from banking institutions, on 62,000 claims from those liable for checks paid to wrong parties. These claims were in addition to those involving 117,000 substitute checks for \$105.6 million issued to replace checks that were not received or were lost, stolen, or destroyed.

If financial institutions depart from present procedures in cashing checks drawn on the Treasurer of the United States, it is reasonable to assume that the fraudulent negotiation of such checks would increase significantly and losses would increase beyond the \$9.3 million reported for 1971. We believe inner-city banks, which can least afford to suffer heavy losses, would be hit the hardest.

If the Congress decides to enact this legislation, it is requested that similar practice adopted with respect to the cashing of savings bonds by banks be applied to checks, and that the bill be amended to include a provision relieving banks from any loss incurred in paying checks to the wrong persons if they follow identification procedures prescribed by the Secretary of the Treasury. A suggested provision for this purpose is as follows:

Insert the following new section 102 after section 101 of Amendment 1364 to S. 3652 (and re-number the subsequent sections):

"Any insured institution honoring a check drawn on the Treasurer of the United States for a payee on the basis of adequate identification, as prescribed by the Secretary of the Treasury, shall be relieved of any liability to the United States for the amount of such check paid to the wrong person, if such payment was made without fault or negligence by the insured institution, and the Secretary of the Treasury is authorized to pay to the drawee the amount of such check from the fund established by the Government Losses in Shipment Act, as amended, which fund is hereby made available for such purposes."

Mr. Chairman, banks are certainly willing to cooperate in the check-cashing process, provided losses can be kept to a minimum and indemnification procedures are provided. In this connection, I would like to cite what banks have been doing in the nearby States of Maryland and Pennsylvania, two of a number of examples of banks meeting their community responsibilities in this matter.

The "Philadelphia Plan," developed jointly by the State of Pennsylvania and the Pennsylvania banks, and introduced in Philadelphia last October on an experimental basis, provides that:

1. Selected welfare recipients be assigned to a bank.
2. Their check be mailed to the bank.
3. They go to the bank within five days to pick up their check—if not collected in five days the bank mails the check back to the State.
4. The State provides each recipient with a tamper-proof identification card with the recipient's picture, signature and case number. (If one tries to slice the card to insert a different picture, it comes apart.)
5. A representative from the Department of Welfare be assigned to the bank to answer questions.
6. The State of Pennsylvania indemnify the bank against loss.
7. The State of Pennsylvania pay the bank 30 cents for each check handled.

John G. Delsing, Director of the Bureau of Systems Development for the State's Welfare operation, said in an interview two weeks ago that the cooperation of the banks has been "just excellent—they've been going out of their way to help us." He added that the program "definitely is a success."

In Maryland, a special committee of the Maryland Bankers Association recently developed a plan to facilitate the cashing of public assistance checks. The plan provides that:

1. All banks in Maryland will provide check cashing facilities to welfare recipients provided:

A. The State of Maryland issues the recipient a tamper proof identification card bearing the individual's photograph, signature, case number identical to that on recipient's check, date of issue of the card, and a counter signature by a State official attesting to the authenticity of the photograph and signature.

B. The State of Maryland indemnifies the bank against loss provided the check cashed was presented for payment with the use of a State issued identification card and provided the teller noted on the back of the check the issue date shown on the identification card.

2. The banks of Maryland will make no charge for this service during the testing period. However, the Maryland banking industry reserves the right to reevaluate the cost factors involved at the end of the six month experimental program.

3. The State shall provide for the mailing of welfare checks on Mondays, Tuesdays or Wednesday. It is to the advantage of the public assistance recipient who desires to use bank facilities for the cashing of checks not to receive the check on Friday or Monday which are the two busiest days in any bank's operations.

4. The program's effectiveness will be reviewed with the Board of Public Works following a six month testing period.

Both the Maryland and Philadelphia plans are designed to afford check-cashing facilities for those welfare recipients without accounts, and contain the vital elements of tamper-proof identification and indemnification. In addition, the Maryland banks will provide the State with expert personnel in photo identification systems to aid that State in developing the most effective identification system at the lowest possible cost.

This same kind of banker-government cooperation should be undertaken at the Federal level before any legislation in this area is enacted and implemented. The American Bankers Association is ready to cooperate.

#### 100 PERCENT INSURANCE FOR PUBLIC DEPOSITS

(Title III of Amendment 1364 to S. 3652)

The American Bankers Association opposes the proposed Title III of Amendment 1364, which would extend insurance coverage of public deposits to 100 percent. We do not believe that this proposal is in the public interest.

Under the provisions of this title, the deposits of public entities in banks and savings and loan associations would be 100 percent insured. The Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation would have the authority to establish limits on the aggregate amount of public funds which the insured institution could legally hold.

We recognize the importance of deposit insurance in providing reasonable protection against loss due to the failure of an insured institution. We feel, however, that there is already a satisfactory method for protecting public deposits above the present insurance limit. In most States, public funds deposited in banks are protected by the pledging of acceptable assets for the amount above the insurance limit, and in the majority of these States, pledging requirements cover at least 100 percent of these funds. By the pledging approach we have what is essentially 100 percent insurance on public accounts. We question if this legislation will provide a better means of protecting these funds.

Our primary concern is what will happen if pledging requirements no longer exist. Banks would be freed from holding an estimated minimum of \$43 billion in securities that are currently pledged against State and local deposits, and at least an additional \$14 billion pledged against Federal deposits.

The release of pledged securities as a result of 100 percent insurance could have an adverse impact on the Federal, State and local government securities markets. In testimony on June 20, 1972 before the House Subcommittee on Bank Supervision and Insurance, Chairman Martin of the Federal Home Loan Bank Board expressed this same concern in these words:

"It is likely that removal of the insurance limitation on public unit accounts, accompanied by a change in the insurance regulations, would reduce the purchase of both Treasury and municipal obligations by commercial banks. An adverse impact on demand for these obligations would increase borrowing costs for the Treasury and State and local governments. Given a sizable amount of such obligations which are pledged against public unit accounts, an increase in these

borrowing costs is likely to be reflected ultimately in an increase in cost levels in the economy generally."

In 1971 testimony before the House Banking and Currency Committee on a similar provision in H.R. 5700, Chairman Burns of the Federal Reserve Board said:

"A sizable portion of the Treasury and municipal obligations held by banks is pledged under the collateral requirements. For example, according to the latest survey available (1966), over half of the Treasury obligations held by commercial banks were pledged for this purpose; among larger banks the proportion was even higher. Extending insurance coverage as proposed in H.R. 5700 would reduce the attractiveness of such securities as investments for the banks, and thus tend to raise borrowing costs for the Federal, State and local governments."

Banks would have to maintain a certain level of these obligations for liquidity purposes and would want to hold some obligations to help meet their community responsibilities. However, since such a large amount is held only for pledging, it is questionable whether the present high level would continue without pledging requirements. A drop in demand could raise the cost of borrowing, and therefore have a detrimental effect on government financing, particularly for small municipalities whose obligations are unrated and generally not traded in the national market.

Supporters of 100 percent insurance coverage state that there would be significant benefits to the socially important housing area. However, public deposits are not suitable for long term mortgage investment. The experience of commercial banks shows that public funds, even time deposits, are highly volatile. For example, from the beginning of 1968 until the end of that year, State and local time deposits in banks increased by 20 percent. One year later, at the end of 1969, these time deposits had decreased by 30 percent. Under prudent financial practice, such volatile funds require a large liquidity cushion.

Meeting the enlarged liquidity needs would leave only small amounts available for long term lending.

The Federal Reserve Board has expressed similar reservations. In a letter of June 15, 1972, included in the hearings of the House Subcommittee on Bank Supervision and Insurance, Tynan Smith, Secretary of the Federal Reserve Board, stated that:

"The Board is aware that supporters of the proposed legislation anticipate that public benefits may flow from a possible shift of deposits to federally insured savings and loan associations providing additional funds for mortgage lending. In the Board's judgment it is unlikely that any resulting benefits would be of such significance as to outweigh the possible adverse effects [on the market for Treasury and municipal obligations]. Moreover, diversion of volatile public deposits to savings and loan associations where they would be invested in less liquid form than at commercial banks would raise questions of public financial policy."

Finally, we have always opposed increasing insurance levels to where there would be little reason for a depositor to consider differences in the management and soundness of individual institutions. The proposed 100 percent insurance for public deposits could be a step towards 100 percent insurance for all depositors. We agree with the reasoning of the President's Commission on Financial Structure and Regulation in rejecting the 100 percent insurance concept. The Commission recommends more freedom from regulation and more risk-taking by financial institutions. If the FDIC or the FSLIC is to be held fully responsible for deposits, an important incentive for good management would be lost since those with large deposits would have no reason to scrutinize the soundness of an institution or its management capabilities. We feel strongly that the continuance of this incentive is in the public interest.

Title III of Amendment 1364 to S. 3652 should be deleted.

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THE AMERICAN BANKERS ASSOCIATION,  
Washington, D.C., August 4, 1972.

HON. JOHN SPARKMAN,  
Chairman, Committee on Banking, Housing and Urban Affairs,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We have had an opportunity to review the lists of 100 banks with the highest proportion of state and local deposits and the list of

potential state taxes on intangible personal property which were discussed at the hearing on S. 3652 last Tuesday, and I enclose two memoranda commenting on these matters. I wish you would make these a part of the record.

Very sincerely,

CHARLES R. MCNEILL,  
*Executive Director.*

THE AMERICAN BANKERS ASSOCIATION,  
*August 4, 1972.*

OFFICE MEMORANDUM

To : Charles McNeill.

From : Kathleen O'Flaherty.

Subject : Lists of the 100 Insured Commercial Banks with the Largest Ratios of Total State and Local Government Deposits to Total Deposits.

During the hearings on 100 Percent Insurance for Public Deposits, Senator Proxmire referred to a FDIC list of the 100 Insured Commercial Banks with the Largest Ratio of Total State and Local Government Deposits to Total Deposits. Attached are these lists for December, 1970 and December, 1971.

In 1971 sixteen banks in the United States—.001 percent—had more than half of their deposits consisting of State and local deposits. This small group is no cause for alarm, since these banks are under the supervision of public regulatory authorities. Furthermore, in the majority of States, these funds are fully protected by pledging requirements.

These lists provide an excellent example of the volatility of State and local government deposits. A column has been added to the data supplied by the FDIC noting the changes in the ranking of banks between the two years. Over half of the banks listed in the 1970 data do not reappear in the 1971 data. The bank with the greatest ratio in 1970 (79.29 percent) is not included among the list of one hundred banks in 1971. The highest ratio in December, 1971 was 71.25, more than 8 percentage points lower than the highest concentration in 1970. However, there is no way to ascertain if public deposits are becoming more or less concentrated. Of the forty-nine banks which appear on both lists, about half of them moved higher in the ranking from 1970 to 1971, indicating that State and local deposits were growing more rapidly than total deposits, and about half of the banks moved lower in ranking, indicating that total deposits were growing more rapidly. The only clear conclusion that can be drawn from this data is that these funds are volatile ones.

These lists also demonstrate that the special situations of individual banks are important in determining the amounts of State and local funds they hold.

One bank which has a very high ratio of State and local government deposits to total deposits is located in a redevelopment area of the city which it serves. The city government decided that for community priority reasons this bank should hold the funds for redevelopment projects such as housing. The bank is relatively new, replacing a failed institution in which the FDIC had to pay off depositors. The bank has been striving to build the confidence of the people in the community, and the city government decided its funds could assist the bank in doing this.

The location of some banks, particularly smaller ones, at the county seat helps to explain their disproportionate amount of public deposits. The situation of the bank appearing first on the list in 1970 and not appearing at all the following year is a result of competitive bidding for county funds. In 1971 the bank lost the bid and the funds moved down the street to the bank which ranked eleventh on the 1971 list. Another bank, which bids for county funds, obtains the bulk of its local government deposits the last fifteen days of December (which distorts year-end figures); the county withdraws the major portion of these funds on January 20th of each year, making these very short-term funds.

The location of a bank in a State capital also influences a bank's ratio of public deposits to total deposits. The case of one bank having an unusually high ratio is applicable to other banks. The bank is the general depository for the State. The State has a policy of keeping all of its operating funds in one bank. These funds are held as demand deposits, and the resources of the bank can vary as much as 25 percent a day. Another bank located in a State capital, while not the official fiscal agent of that State, holds large amounts of State funds for meeting State disbursement needs, such as payrolls. A major portion of these funds are

in demand deposits which can fluctuate considerably depending on the time of the year and the day of the week.

Not all banks are interested in public deposits. The volatility of the funds and pledging requirements limit the uses that can be made of the funds. However, there are banks, especially some smaller ones, interested in State and local deposits because these funds can be used to grow. These banks feel confident that they can handle large deposits and that they can assess their own limitations in determining the amount of public funds they should accept.

THE 100 INSURED COMMERCIAL BANKS WITH THE LARGEST RATIOS OF TOTAL STATE AND LOCAL GOVERNMENT DEPOSITS TO TOTAL DEPOSITS, DECEMBER 1970

(In thousands of dollars)

Rank in 1971 and bank name	Total deposits	Total State and local government deposits	Ratio
Jefferson Trust Co., Hillsboro, Mo.....	8,547	6,777	79.29
(3) Bank of Newport News, Newport News, Va.....	7,117	5,026	70.61
American Bank of Commerce, Oklahoma City, Okla.....	3,231	2,121	65.95
(1) Farmers Bank & Capital Trust Co., Frankfort, Ky.....	97,579	61,136	62.65
(13) First State Bank of San Diego, San Diego, Tex.....	7,017	4,391	62.57
(2) Civic Plaza National Bank of Kansas City, Mo.....	21,256	13,069	61.48
(9) Mequon National Bank, Mequon, Wis.....	6,237	3,744	60.02
(5) The Peoples Bank, Clio, Ala.....	4,434	2,655	59.87
(60) Peoples Bank & Trust Co., Anchorage, Alaska.....	6,755	3,905	57.80
Marengo State Bank, Marengo, Ind.....	9,468	5,394	56.97
Midtown National Bank, Pueblo, Colo.....	6,305	3,488	55.32
(4) Merritt Island Bank, Merritt Island, Fla.....	2,023	1,050	51.90
(24) First State Bank, Smiths, Ala.....	1,165	601	51.58
(42) Burlington Bank & Trust Co., Burlington, Mass.....	12,959	6,629	51.15
The First Marion Bank, Ocala, Fla.....	10,277	5,252	51.10
(8) Main Bank & Trust, San Antonio, Tex.....	71,074	35,778	50.33
(6) Capitol Bank & Trust Co., Boston, Mass.....	52,151	26,132	50.10
(21) First Security Bank of Helena, Helena, Mont.....	4,686	2,386	50.06
(18) First State Bank, Phil Campbell, Ala.....	3,779	1,885	49.88
Columbia Gorge Bank, Stevenson, Wash.....	8,199	4,041	49.28
(40) Oklahoma National Bank of Norman, Okla.....	8,051	3,957	49.14
(31) State Bank of Albany, Albany, N.Y.....	743,252	361,249	48.60
(15) Iraan State Bank, Iraan, Tex.....	2,008	975	48.55
First National Bank of Lakeland, Fla.....	19,142	9,204	48.08
(26) De Soto State Bank, De Soto, Kans.....	5,481	2,617	47.74
Peoples Bank & Trust Co., Indianapolis, Ind.....	74,757	35,246	47.14
The United Bank & Trust Co. of Oxon Hill, Md.....	15,708	7,306	46.51
Spencer County Bank, Santa Claus, Ind.....	7,591	3,481	45.85
The First State Bank of Portis, Kans.....	550	251	45.63
The Bank of Crowley, Crowley, Tex.....	1,935	881	45.52
(75) The Citizens' Bank of Euflala, Ala.....	8,246	3,743	45.39
(53) State Bank & Trust Co., San Marcos, Tex.....	20,733	9,302	44.86
The Bank of Bunker, Bunker, Mo.....	2,277	1,018	44.70
(20) First State Bank of Winter Garden, Fla.....	2,563	1,139	44.44
Oak Creek Marine National Bank, Oak Creek, Wis.....	8,499	3,766	44.31
(10) Citizens Bank of Las Cruces, N. Mex.....	3,715	1,628	43.82
First State Bank of Denton, Tex.....	49,927	21,874	43.81
Bank of Hawaii, American Samoa.....	8,222	3,585	43.60
Centennial State Bank of Lexington, Minn.....	5,032	2,194	43.60
(45) Deer Park Bank, Deer Park, Tex.....	14,520	6,295	43.35
Bank of Pullman, Pullman, Wash.....	289	125	43.25
(64) Bank of Hawthorne, Hawthorne, Fla.....	3,639	1,573	43.22
(27) People Bank & Trust Co. of Chalmette, La.....	15,309	6,600	43.11
(56) The First Mustang State Bank, Mustang, Okla.....	2,067	887	42.91
(52) The State Bank of Spring Hill, Spring Hill, Kans.....	4,540	1,932	42.55
National Bank of Commerce of Birmingham, Ala.....	17,847	7,564	42.38
The First Bank of Cordova, Cordova, Alaska.....	5,707	2,406	42.15
(84) McColl State Bank, McColl, S.C.....	1,972	831	42.13
Southeast National Bank of Orlando, Fla.....	3,816	1,593	41.74
(55) The United State Bank of Sminole, Sanford, Fla.....	7,369	3,076	41.74
(57) Alaska State Bank, Anchorage, Alaska.....	56,341	23,499	41.70
(37) Bank of Pleasant Hill, Pleasant Hill, La.....	1,988	826	41.54
(61) University Bank of Carbondale, Ill.....	13,160	5,462	41.50
Security Bank & Trust Company, Midwest City, Okla.....	10,690	4,432	41.45
(58) United National Bank, Cocoa Beach, Fla.....	11,883	4,900	41.23
(35) The Jefferson Bank & Trust Co., Jefferson Parish, La.....	15,437	6,356	41.17
West Deptford Bank, West Deptford Township, N.J.....	5,984	2,456	41.04
(54) Bank of New Mexico, Albuquerque, N. Mex.....	104,646	42,832	40.93
Peoples State Bank, Grinnell, Kans.....	1,756	712	40.54
The First National Bank of Jacksonville, Ala.....	12,756	5,146	40.34
(62) Matanuska Valley Bank, Anchorage, Alaska.....	51,641	20,787	40.25
The State Bank of Oskaloosa, Kans.....	4,680	1,883	40.23
The First National Bank of Petersburg, Ind.....	14,455	5,806	40.16

THE 100 INSURED COMMERCIAL BANKS WITH THE LARGEST RATIOS OF TOTAL STATE AND LOCAL GOVERNMENT DEPOSITS TO TOTAL DEPOSITS, DECEMBER 1970—Continued

(In thousands of dollars)

Rank in 1971 and bank name	Total deposits	Total State and local government deposits	Ratio
(72) The Central Trust Bank, Jefferson City, Mo.....	117,553	46,960	39.94
First National Bank of, Gretna, La.....	135,936	54,200	39.87
First State Bank in, Davidson, Okla.....	1,175	468	39.82
New Berlin State Bank, New Berlin, Wis.....	9,758	3,886	39.82
The Citizens Bank of Oviedo, Fla.....	7,311	2,880	39.39
The Falun State Bank, Falun, Kans.....	976	383	39.24
First National Bank of, Denham Springs, La.....	7,772	3,049	39.23
The Peoples Bank, Willcox, Ariz.....	2,627	1,029	39.17
(39) Texas State Bank, Austin, Tex.....	29,848	11,673	39.10
The Samson Banking Co., Inc., Samson, Ala.....	6,250	2,443	39.08
Ellensburg State Bank, Ellensburg, Wash.....	4,010	1,567	39.07
(94) Glen Lake State Bank of, Minnetonka, Minn.....	5,826	2,276	39.06
Jefferson Bank & Trust Co., St. Louis, Mo.....	71,632	27,798	38.80
(44) The State Bank of Stanley, Stanley, Kans.....	5,397	2,090	38.72
Cameron State Bank, Cameron, La.....	4,965	1,919	38.65
(22) First National Bank of, Warren, Mich.....	26,357	10,164	38.56
(96) The First National Bank of, Dexter, N.Y.....	4,049	1,558	38.47
(47) Watkins Banking Co., Faunsdale, Ala.....	733	282	38.47
First National Bank in, Las Vegas, N. Mex.....	9,959	3,818	38.33
First Trust Co. in, Albany, N.Y.....	181,095	68,770	37.97
V.I., National Bank, Charlotte Amalie, V.I.....	170,567	45,764	37.95
(80) The First National Bank of, Stillwater, Minn.....	31,906	12,093	37.90
(66) The First National Bank of, Olathe, Kans.....	17,527	6,637	37.84
Washington Bank & Trust Co., of, Naperville, Ill.....	3,894	1,473	37.82
Bank of Jacomo, Blue Springs, Mo.....	3,042	1,150	37.80
Kent County State Bank, Jayton, Tex.....	2,364	893	37.77
Romona State Bank, Romona, Kans.....	428	161	37.61
American Bank & Trust Co., Baton Rouge, La.....	236,741	88,399	37.33
First City Bank of Newport News, Va.....	8,042	2,998	37.27
(14) The American National Bank of, Austin, Tex.....	156,328	58,267	37.27
(12) Clayton Bank, Clayton, Mo.....	57,148	21,285	37.24
(85) The Merchants Bank, Bolton, Miss.....	1,976	734	37.14
The Peoples Bank of, Spotsylvania Court House, Va.....	2,718	1,008	37.08
(90) The Suffolk County National Bank of Riverhead, N.Y.....	38,083	14,091	37.00
Bank of Fort Mill, S.C.....	5,281	1,945	37.00
American Bank of Commerce, Albuquerque, N. Mex.....	36,080	13,345	36.98
National Commercial Bank & Trust, Albany, N.Y.....	704,762	260,479	36.95

THE 100 INSURED COMMERCIAL BANKS WITH THE LARGEST RATIOS OF TOTAL STATE AND LOCAL GOVERNMENT DEPOSITS TO TOTAL DEPOSITS, DECEMBER 1971

(In thousands of dollars)

Rank in 1970 and bank name	Total deposits	Total State and local government deposits	Ratio
(4) The Farmers Bank & Capitol Trust Co., Frankfort, Ky.....	145,840	103,911	71.25
(6) Civic Plaza National Bank of Kansas City, Kansas City, Mo.....	22,891	14,522	63.43
(2) Bank of Newport News, Newport News, Va.....	7,865	4,912	62.45
(12) Merritt Island Bank, Merritt Island, Fla.....	7,624	4,718	61.88
(8) The Peoples Bank, Clio, Ala.....	4,705	2,905	61.74
(17) Capitol Bank & Trust Co., Boston, Mass.....	59,253	34,677	58.51
Harbor National Bank of Boston.....	41,113	23,894	58.11
(16) Main Bank & Trust, San Antonio, Tex.....	91,953	52,868	57.49
(7) First Wisconsin National Bank of Mequon, Mequon, Wis.....	7,394	4,195	56.73
(36) Citizens Bank of Las Cruces, Las Cruces, N. Mex.....	9,457	5,289	55.92
Bank of Hillsboro, Hillsboro, Mo.....	9,527	5,086	53.38
(94) Clayton Bank, Clayton, Mo.....	83,948	43,962	52.36
(5) First State Bank of San Diego, San Diego, Tex.....	8,632	4,393	50.89
(93) American National Bank of Austin, Austin, Tex.....	200,139	100,895	50.41
(23) Iraan State Bank, Iraan, Tex.....	2,200	1,105	50.22
Fairfield State Bank, Fairfield, N.J.....	3,919	1,964	50.11
Suburban West State Bank, Goddard, Kans.....	1,566	782	49.93
(19) First State Bank, Campbell, Ala.....	4,618	2,287	49.52
First National Bank of Lakeland, Lakeland, Ohio.....	26,951	13,313	49.39
(34) First State Bank of Winter Garden, Winter Garden, Fla.....	4,814	2,365	49.12
(18) First Security Bank of Helena, Helena, Mont.....	8,839	4,337	49.06
(79) First National Bank of Warren, Warren, Mich.....	39,268	18,742	47.72
Peoples Bank Charlotte Amalie, V.I.....	10,492	5,000	47.65
(13) First State Bank, Smiths, Ala.....	1,178	561	47.62
First State Bank of McKinney, McKinney, Tex.....	3,254	1,541	47.35
(25) De Soto State Bank, De Soto, Kans.....	6,001	2,820	46.99

THE 100 INSURED COMMERCIAL BANKS WITH THE LARGEST RATIOS OF TOTAL STATE AND LOCAL GOVERNMENT DEPOSITS TO TOTAL DEPOSITS, DECEMBER 1971—Continued

(In thousands of dollars)

Rank in 1970 and bank name	Total deposits	Total State and local government deposits	Ratio
(43) Peoples Bank & Trust, Chalmette, La	19,999	9,373	46.86
Northwestern National Bank of Hastings, Hastings, Minn	31,111	14,485	46.55
Cofax Banking Co., Cofax, La	3,062	1,421	46.40
Nevada State Bank, Las Vegas, Nev	67,147	30,523	45.45
(22) State Bank of Albany, Albany, N.Y.	686,440	311,313	45.35
Randolph Field National Bank, Universal City, Tex	17,846	8,036	45.02
Fredonia State Bank, Nacogdoches, Tex	11,849	5,333	45.00
Carabell Bank, Carabell, Fla	2,385	1,060	44.44
(56) Jefferson Bank & Trust, Jefferson Parish, La	23,851	10,570	44.31
First State Bank of Portis, Portis, Tex	560	248	44.28
(52) Bank of Pleasant Hill, Pleasant Hill, La	2,215	972	43.88
Seminole State Bank, Seminole, Tex	14,809	6,436	43.46
(72) Texas State Bank, Austin, Tex	35,602	15,450	43.39
(21) Oklahoma National Bank of Norman, Norman, Okla	8,523	3,683	43.21
Eastern Washington Bank, Moses Lake, Wash	2,541	1,095	43.09
(14) Burlington Bank & Trust, Burlington, Mass	14,780	6,342	42.90
Community Bank of Boco Raton, Boca Raton, Fla	4,429	1,900	42.89
(77) State Bank of Stanley, Stanley, Kans	6,750	2,868	42.48
(40) Deer Park Bank, Deer Park, Tex	16,768	7,123	42.47
Augarland State Bank, Jeanett, La	2,061	873	42.35
(81) Watkins Banking Co., Faunsdale, Ala	782	328	41.94
Mercantile Bank & Trust, Gretna, La	14,376	6,029	41.93
First American Bank of North Palm Beach, Palm Beach, Fla	44,561	18,641	41.83
Colonial Bank, New Orleans, La	27,668	11,559	41.77
Bank of Commerce & Trust Co., Francisville, La	9,037	3,744	41.42
(45) State Bank of Spring Hill, Spring Hill, Kans	5,416	2,223	41.04
(32) State Bank & Trust Co., San Marcos, Tex	19,738	8,098	41.02
(58) Bank of New Mexico, Albuquerque, N. Mex	122,031	50,050	41.01
(50) United State Bank of Seminole, Sanford, Fla	9,808	4,018	40.96
(44) First Mustang State Bank, Mustang, Okla	2,417	989	40.91
(51) Alaska State Bank, Anchorage, Alaska	62,161	25,372	40.81
(55) United National Bank, Cocoa Beach, Fla	14,257	5,796	40.65
Summit County Bank, Fisco, Colo	4,023	1,630	40.51
(9) Peoples Bank & Trust, Anchorage, Alaska	10,964	4,421	40.32
(53) University Bank of Carbondale, Carbondale, Ill	13,523	5,449	40.29
(61) Matanuska Valley Bank, Anchorage, Alaska	53,176	21,426	40.29
The Community Bank, Lake Oswego, Oreg	7,869	3,165	40.22
(42) Bank of Hawthorne, Hawthorne, Fla	4,300	1,696	39.44
Metropolitan Bank of Syracuse, Syracuse, N.Y	48,727	19,211	39.42
(86) The First National Bank of Olathe, Olathe, Kans	21,721	8,547	39.34
Western Bank, Billings, Mont	1,363	536	39.32
Lyon County State Bank, Emporia, Kans	9,947	3,906	39.26
First Security Bank & Trust, Carrollton	9,895	3,884	39.25
Charlotte County National Bank, Port Charlotte, Fla	2,513	977	38.87
The First National Bank of Jacksonville, Jacksonville, Fla	14,520	5,642	38.85
(64) The Central Trust Bank, Jefferson City, Mo	125,277	48,599	38.79
The First National Bank of Anchorage, Anchorage, Alaska	194,076	75,242	38.76
Bank of Northern Utah, Clearfield, Utah	1,898	734	38.67
(31) Citizens Bank of Eufaula, Eufaula, Ala	9,079	3,501	38.56
Rocks County State Bank, Woodston, Kans	1,242	478	38.48
First Bank and Trust, Bryan, Tex	51,420	19,756	38.42
Baton Rouge Bank & Trust Co., Baton Rouge, La	28,007	10,740	38.34
City & County Bank of Powell, Powell, Tenn	2,388	915	38.31
(85) First National Bank of Stillwater, Stillwater, Minn	35,997	13,750	38.20
Baker Bank & Trust Co., Baker, La	22,538	8,587	38.10
Midtown National Bank, Pueblo, Colo	4,693	1,784	38.01
Citizens Bank of Edinburg, Edinburg, Ill	1,762	669	37.96
(48) McColl State Bank, McColl, S. C	2,285	866	37.89
(95) Merchants Bank, Bolton, Miss	2,047	774	37.81
Lyndon State Bank, Lyndon, Kans	5,692	2,140	37.59
First National Bank of Stafford, Stafford, Tex	11,061	4,156	37.57
First National Bank of Newport, Newport, N.H	3,554	1,334	37.53
State Bank of Kingsville, Kingsville, Tex	11,897	4,462	37.50
(97) The Suffolk County National Bank, Riverhead, N.Y	43,700	16,297	37.29
Imperial Bank of Lakeland, Lakeland, Fla	19,778	7,370	37.26
Custer County State Bank, Arapah, Okla	1,185	441	37.21
First National Bank in Grand Prairie, Grand Prairie, Tex	17,810	6,625	37.19
(75) Glen Lake State Bank of Minnetonka, Minnetonka, Minn	6,964	2,588	37.16
State Bank of Belmont, Belmont, N.Y	2,271	843	37.12
(80) First National Bank of Dexter, Dexter, N.Y	4,153	1,541	37.10
The First National Bank of Clayton, Clayton, Mo	103,131	38,053	36.89
Hamilton Bank, Hamilton Township, N.J	8,488	3,110	36.63
Gulf Coast Bank, Abbeville, La	3,670	1,340	36.51
Bank of Springville, Springville, Ala	2,740	999	36.45

ADDITIONAL MEMORANDUM FROM THE AMERICAN BANKERS ASSOCIATION

The attached table shows the State and local taxes paid in 1969 by commercial banks in the 50 States and the District of Columbia (not including any Federal taxes), including specifically net income and bank share taxes, taken from the Federal Reserve Board Study (Committee Print dated June, 1972, pages 126-142), except as noted, and the estimates of intangible personal property taxes which could be raised from banks in each State if imposed on the Florida assessment base as of June 30, 1971 and at approximately the Florida tax rate, according to the Library of Congress statement dated July 31, 1972. Columns II and III below do not include unusually large taxes in some States, which are included in column IV: Arizona, \$1.3 million, real property; Arkansas, \$1.4 million, tangible personal property; District of Columbia, \$3.2 million gross income or receipts; Illinois, \$11.0 million, real property; Indiana, \$3.6 million, real property, \$3.7 million, gross income or receipts, \$8.3 million, miscellaneous deductible; Michigan, \$7.5 million, bank deposits; Nebraska, \$1.0 million, real property; New Hampshire, \$6 million, real property; New Jersey, \$8.2 million, real property; Ohio, \$30.0 million, bank deposits; Tennessee, \$1.0 million, tangible personal property; and, Washington, \$2.5 million, real property, \$1.7 million, sales tax.

[In millions of dollars]

State	Estimated tax on intangibles June 30, 1971	Net income taxes paid (1969)	Bank share taxes paid (1969)	Other taxes paid (1969)	Total State and local taxes paid (1969)
	I	II	III	IV	V
Alabama	3.5	3.2	(1)	0.9	4.1
Alaska	.3	(1)		.4	.4
Arizona	2.9	.7		1.5	2.2
Arkansas	1.9	(1)	.1	2.2	2.3
California	35.5	42.9	(1)	24.1	67.0
Colorado	3.3	3.1	(1)	2.3	5.4
Connecticut	3.5	8.7		3.4	12.1
Delaware	.8	.8	.2	.4	1.4
District of Columbia	1.7			4.3	4.3
Florida	9.0	10.0	3.9	6.2	47.1
Georgia	5.6	(1)	7.1	3.3	10.4
Hawaii	1.1	1.0		.9	1.9
Idaho	1.0	1.0	(1)	.4	1.4
Illinois	27.0	2.7	15.0	12.9	30.6
Indiana	6.8			15.9	15.9
Iowa	4.2	(1)	2.5	2.7	5.2
Kansas	3.5	2.5		2.1	4.6
Kentucky	3.2		3.8	1.3	5.1
Louisiana	4.2	(1)	12.7	1.8	14.5
Maine	.9	(1)	.6	.9	1.5
Maryland	3.4	4.9		1.9	6.8
Massachusetts	9.0	14.5		7.8	22.3
Michigan	12.0	10.0	.2	15.2	25.4
Minnesota	6.0	10.7		4.9	15.6
Mississippi	2.1	(1)	1.3	1.7	3.0
Missouri	7.6	9.5	(1)	3.2	12.7
Montana	1.1		2.4	.9	3.3
Nebraska	2.7	.8		1.2	2.0
Nevada	.8		.7	.6	1.3
New Hampshire	.6	(1)	.2	.6	.8
New Jersey	9.3	(1)	6.9	9.1	16.0
New Mexico	1.2	1.0	(1)	.5	1.5
New York	74.4	90.9	(1)	41.7	132.6
North Carolina	5.6	3.6	(1)	2.2	5.8
North Dakota	.9	.6	(1)	.5	1.1
Ohio	14.3	(1)	3.5	35.9	39.4
Oklahoma	4.1	3.9	(1)	1.6	5.5
Oregon	2.8	3.2		1.8	5.0
Pennsylvania	21.6	(1)	27.5	11.3	38.8
Rhode Island	1.1	1.6	(1)	1.6	3.2
South Carolina	1.8	1.3		.6	1.9
South Dakota	1.0	.7		.8	1.5
Tennessee	5.3	1.5	2.8	4.6	8.9
Texas	20.3		25.9	15.1	41.0
Utah	1.2	2.0		.8	2.8
Vermont	.5	.5		.4	.7
Virginia	5.6	.2	4.7	1.8	6.7

See footnotes at end of table.

[In millions of dollars]

State	Estimated tax on intangibles June 30, 1971	Net income taxes paid (1969)	Bank share taxes paid (1969)	Other taxes paid (1969)	Total State and local taxes paid (1969)
	I	II	III	V	V
Washington.....	4.4		(1)	5.2	5.2
West Virginia.....	1.8	(1)	.9	1.0	1.9
Wisconsin.....	5.6	7.1		5.0	12.1
Wyoming.....	.5		.5	.2	.7
Total.....	348.5	244.9	120.4	267.6	622.9

<sup>1</sup> Less than \$100,000.

<sup>2</sup> Florida franchise tax, measured by income, including income from tax exempts, estimated for calendar year 1972.

<sup>3</sup> Florida bank share tax, 1969, since repealed.

<sup>4</sup> Total taxes paid, 1969, on basis of \$9,000,000 bank share tax.

<sup>5</sup> New Jersey bank share tax, increased in 1971. 1971 figures—col. III, 15.2; col. IV, 24.2.

The CHAIRMAN. Next is Mr. Thomas Roby, first vice president, Credit Union National Association, Inc.

Mr. Roby, do you have a prepared statement?

We shall be glad to hear from you.

For the benefit of the record, please identify the gentlemen with you.

**STATEMENT OF THOMAS E. ROBY, FIRST VICE PRESIDENT, CREDIT UNION NATIONAL ASSOCIATION, INC., ACCOMPANIED BY HERB WEGNER, MANAGING DIRECTOR, AND GERALD HYLAND, LEGISLATIVE COUNSEL**

Mr. ROBY. Mr. Chairman and members of this committee, I am Thomas Roby, first vice president of the Credit Union National Association, Inc., and past president of the South Dakota Credit Union League.

I am accompanied by Herb Wegner, managing director of the Credit Union National Association, Inc., on my left; and Mr. Gerald Hyland, our legislative counsel, on my right.

Before I present the views of the Credit Union National Association on the legislation being considered by your committee I wish to explain that the Credit Union National Association is an association composed of both Federal and State chartered credit unions.

Nine out of 10 of the 23,261 credit unions in the United States are represented in our membership, with approximately the same ratio of Federal and State credit unions represented.

We are here today concerning amendment No. 1364 to S. 3652 offered by Senator Proxmire which would provide, among other things, for 100-percent deposit insurance for public funds maintained at federally insured banks and savings and loan associations.

As presently proposed this amendment would not include credit unions.

However, today more than 14,000 credit unions in the United States are federally insured by the Administrator of the National Credit Union Administration, pursuant to Public Law 91-468.

It seems logical and equitable that these federally insured credit unions be permitted equality of treatment concerning the receipt of

public funds and the 100-percent insurance thereof on a par with other federally insured institutions.

Accordingly, we suggest an amendment to the full deposit insurance for public units provisions as follows:

Subsection (c) of section 207 of the Federal Credit Union Act (12 U.S.C. 1787) is amended by—

(1) Inserting "(1)" after "(e)",

(2) Striking out "For the purposes of this subsection" and inserting in lieu thereof the following "Subject to the provisions of paragraph (2), for the purposes of this subsection", and

(3) Adding at the end thereof the following:

"(2) (A) Notwithstanding any limitation in this Act or in any other provision of law relating to the amount of insurance available for the account of any one depositor or member, in the case of a depositor or member who is—

"(i) an officer, employee or agent of the United States having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title;

"(ii) an officer, employee or agent of any state of the United States, or of any country, municipality, or political subdivision thereof having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title in such state;

"(iii) an officer, employee or agent of the District of Columbia having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title in the District of Columbia; or

"(iv) an officer, employee, or agent of the Commonwealth of Puerto Rico, of the Panama Canal Zone, or of any territory or possession of the United States, or of any county, municipality, or political subdivision thereof having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title in the Commonwealth of Puerto Rico, the Panama Canal Zone, or any such territory or possession, respectively;

his account shall be insured for the full aggregate amount of such account.

(B) The Administrator may limit the aggregate amount of funds that may be invested or deposited in any credit union insured in accordance with this title by any depositor or member referred to in subparagraph (A) on the basis of the size of any such credit union in terms of its assets."

In addition, Mr. Chairman, in order that the public funds provisions of this legislation may have a viable and meaningful effect on our insured credit unions insofar as their right to receive public funds from State and local governments, we would like to suggest an amendment to section 107(7) of the Federal Credit Union Act.

Presently the Federal Credit Union Act contains substantial restrictions as to a Federal credit union's authority to receive public moneys other than from the Federal Government.

Generally, Federal credit unions are not permitted to receive public funds from State and local governments with the notable exception of those credit unions serving predominantly low-income members (sec. 107(7) of the Federal Credit Union Act).

Thus, in order to achieve relative parity with other federally insured financial institutions and to provide an alternative depository for State and local government funds we suggest the following amendment:

Section 107(7) of the Federal Credit Union Act (12 U.S.C. 1757) is amended by adding at the end thereof—

"And to receive from an officer, employee or agent of those nonmember units of federal, state or local governments and political subdivisions thereof enumerated in Section 207 of the Federal Credit Union Act (12 U.S.C. 1758) and in the manner so prescribed payments on shares, share certificates and share deposits;"

In closing, Mr. Chairman and members of the committee, I thank you on behalf of the Credit Union National Association for the opportunity to appear before you today and for your thoughtfulness and consideration you have always given to legislation affecting the 24,000 credit unions in this country which serve the credit and thrift needs of 23 million Americans.

The CHAIRMAN. Thank you very much, Mr. Roby.

You have a very clear statement. I don't see any particular things in there we need clarification on.

The only thing is I was a little surprised at your presentation because the thought immediately entered my mind, the Government doesn't deposit funds with the credit unions. Credit union deposits are supposed to come from the members.

I think you have cleared that up a little later by saying you feel you are entitled to share those deposits with other financial institutions.

That is really your argument?

Mr. ROBY. Yes, sir.

The CHAIRMAN. Thank you very much. We are very glad to have you.

Mr. ROBY. Thank you.

(The full statement of Mr. Roby follows:)

STATEMENT OF THOMAS ROBY, FIRST VICE PRESIDENT, CREDIT UNION NATIONAL ASSOCIATION, INC.

(Specifically to Amendment No. 1364 to provide 100 percent deposit insurance for public funds maintained at federally insured institutions.)

Mr. Chairman and members of this Committee:

I am Thomas Roby, First Vice President of the Credit Union National Association, Inc. and past president of the South Dakota Credit Union League. I am accompanied by Herb Wegner, Managing Director, Credit Union National Association, Inc., and Gerald Hyland, Legislative Counsel.

Before I present the views of the Credit Union National Association on the legislation being considered by your Committee, I wish to explain that the Credit Union National Association is an association composed of both Federal and state chartered credit unions. Nine out of ten of the 23,261 credit unions in the United States are represented in our membership, with approximately the same ratio of Federal and state credit unions represented.

We are here today concerning Amendment Number 1364 to S. 3652, offered by Senator Proxmire, which would provide, among other things, for 100 percent deposit insurance for public funds maintained at Federally insured banks and savings and loan associations. As presently proposed, this amendment would not include credit unions.

However, today more than 14,000 credit unions in the United States are *Federally* insured by the Administrator of the National Credit Union Administration, pursuant to P.L. 91-468. It seems logical and equitable that these *Federally* insured credit unions be permitted equality of treatment concerning the receipt of public funds and the 100 percent insurance thereof on a par with other *Federally* insured institutions. Accordingly, we suggest an amendment to the "Full Deposit Insurance for Public Units" provisions as follows:

"Subsection (c) of section 207 of the Federal Credit Union Act (12 U.S.C. 1787) is amended by—

- (1) inserting '(1)' after '(e)',
- (2) striking out 'For the purposes of this subsection,' and inserting in lieu thereof the following 'Subject to the provisions of paragraph (2), for the purposes of this subsection', and
- (3) adding at the end thereof the following:

"(2) (A) Notwithstanding any limitation in this Act or in any other provision of law relating to the amount of insurance available for the account of any one depositor or member, in the case of a depositor or member who is—

"(i) an officer, employee, or agent of the United States having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title;

"(ii) an officer, employee, or agent of any State of the United States, or of any county, municipality, or political subdivision thereof having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title in such state;

"(iii) an officer, employee, or agent of the District of Columbia having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title in the District of Columbia; or

"(iv) an officer, employee, or agent of the Commonwealth of Puerto Rico, of the Panama Canal Zone, or of any territory or possession of the United States, or of any county, municipality, or political subdivision thereof having official custody of public funds and lawfully investing the same in a credit union insured in accordance with this title in the Commonwealth of Puerto Rico, the Panama Canal Zone, or any such territory or possession, respectively; and his account shall be insured for the full aggregate amount of such account.

"(B) The Administrator may limit the aggregate amount of funds that may be invested or deposited in any credit union insured in accordance with this title by any depositor or member referred to in subparagraph (A) on the basis of the size of any such credit union in terms of its assets."

In addition, Mr. Chairman, in order that the "public funds" provisions of this legislation may have a viable and meaningful effect on our insured credit unions insofar as their right to receive public funds from state and local governments, we would like to suggest an amendment to Section 107(7) of the Federal Credit Union Act.

Presently, the Federal Credit Union Act contains substantial restrictions as to a Federal credit union's authority to receive public monies other than from the Federal government. Generally, Federal credit unions are not permitted to receive public funds from state and local governments with the notable exception of those credit unions serving predominantly low-income members (Sec. 107(7) of the Federal Credit Union Act).

Thus, in order to achieve relative parity with other Federally insured financial institutions and to provide an alternative depository for state and local government funds, we suggest the following amendment:

"Section 107(7) of the Federal Credit Union Act (12 U.S.C. 175) is amended by adding at the end thereof—

"And to receive from an officer, employee, or agent of those nonmember units of Federal, state or local governments and political subdivisions thereof enumerated in Section 20 of the Federal Credit Union Act (12 U.S.C. 1758) and in the manner so prescribed payments on shares, share certificates and share deposits;"

In closing, Mr. Chairman and members of the Committee, I thank you on behalf of the Credit Union National Association for the opportunity to appear before you today and for your thoughtfulness and consideration you have always given to legislation affecting the 24,000 credit unions in the country which serve the credit and thrift needs of 23 million Americans.

The CHAIRMAN. Next is Stephan K. Small, legislative counsel, Securities Industries Association.

Do you have a prepared statement?

#### STATEMENT OF STEPHAN K. SMALL, LEGISLATIVE COUNSEL, PUBLIC FINANCE DIVISION, SECURITIES INDUSTRIES ASSOCIATION

MR. SMALL. Yes, I do, Mr. Chairman. It is brief and, with your permission, I will read it.

The CHAIRMAN. Go right ahead.

MR. SMALL. Mr. Chairman, the Public Finance Division of the Securities Industries Association represents the firms that underwrite and

trade in municipal bonds and Federal securities and serve as financial advisers to the issuers of those securities—Federal, State and local governments.

We appreciate this opportunity to comment on amendment 1364 to S. 3652 and would like to confine our comments to the proposal that full insurance be provided State and local deposits by the FDIC and the FSLIC.

In effect, the legislation would remove the current \$20,000 ceiling on deposit insurance with respect to public body deposits. A similar provision is contained in the House version of this legislation, H.R. 15656.

We are pleased that Senator Proxmire has brought this issue to the attention of the committee as we feel it deserves careful consideration.

Our concern in appearing before the committee is the potential effect of this legislation on the municipal market and on the borrowing costs of the State and local governments whom we serve.

We would like to address the two major arguments that have been given in favor of the amendment: a need for increased protection of public body deposits and equity among competitors for State and local deposits.

There is in our view no need for public funds to be fully insured as a safeguard against bank failures given the very low incidence of bank closing.

Frank Wille, Chairman of the Federal Deposit Insurance Corporation, discussed in his testimony before the House Subcommittee on Bank Supervision and Insurance on June 20, 1972, a study done by the FDIC on losses of public funds. The study showed that extremely small amounts of public funds have been forfeited in recent years.

Of the almost \$55 million in public deposits in the 56 banks that closed in 1970 through 1971 only \$116,000, or 0.2 percent, was not recovered by the State and municipal governments.

Thus, of the average of \$20 billion on deposit by State and local governments in commercial banks during the period, only seventy-five/ten-thousandths of 1 percent had been lost.

Clearly there have not been sizable losses of public deposits and no need for this legislation is evident on this basis.

The second argument that existing law affords commercial banks a competitive advantage over thrift institutions in securing public body deposits must be considered in the overall context of credit markets.

This "competitive advantage"—to the extent that it may exist—is also an inducement to commercial banks to purchase and maintain in their portfolios State and local government securities.

Full insurance on public deposits would considerably lessen the demand for tax-exempt municipal bonds.

In order to safeguard public funds 38 States and the Federal Government require banks to pledge Federal, State and local securities against public deposits that exceed the \$20,000 insurance ceiling of the FDIC and FSLIC.

Passage of full insurance will eliminate the need for the pledging requirement, with the result that commercial banks will be less inclined to purchase the large amounts of government debt that they now buy.

Moreover, the higher interest rates paid by savings and loan institutions on time deposits will attract municipal deposits away from banks unless there is collateral legislation raising the rates that commercial banks may pay.

Such a transfer of deposits and decline in bank liability will reduce their ability to buy State and local bonds and they will participate less in the municipal bond market.

Furthermore, there will not be a corresponding increase in amounts of State and local securities bought by savings and loan institutions because their preferential income tax treatment makes them uninterested in the purchase of municipal bonds.

The magnitude of the problem is very large. The Federal Reserve Bulletin of June 1972 indicates that commercial banks now currently hold \$82.8 billion in securities of State and local governments, approximately 51 percent of those outstanding.

That same source places \$58 billion in public deposit balances are currently in commercial banks.

The Federal Reserve System has indicated that a larger amount—over \$70 billion—of Federal, State and local government securities are currently used by commercial banks to satisfy pledging requirements.

Either an undercutting of public pledge requirements or a large drop in deposits would surely bring a corresponding decrease in bank holdings of municipal bonds. Such a decrease would force up interest rates on municipal bonds, thus creating a new problem without accomplishing any real gain for the public.

This is not the first time that full insurance of public body deposits has been considered by the 92d Congress. Last year a similar proposal was contained in H.R. 5700.

In his testimony on that provision Federal Reserve Board Chairman Burns expressed this concern about the impact on the market for Federal and municipal obligations.

In his testimony this June on a similar provision in H.R. 15656, Preston Martin, Chairman of the Federal Home Loan Bank Board, stated the administration's opposition which, he said, " \* \* \* is based on the concern that the negative effects may outweigh the positive effects. That concern," he continued, "is a real and serious concern and the Board urges \* \* \* deliberate and weighty consideration."

Governor Mitchell's comments this morning on behalf of the Federal Reserve System add to the concern over this.

We concur in Chairman Martin's call for close examination of this proposal. We intend to assess its potential impact on the municipal market.

We would also recommend that the committee consult representatives of State and local governments before this provision is enacted.

We again urge that the committee give full and careful consideration to the impact of 100 percent insurance on public deposits and stand ready to provide whatever assistance we can.

The CHAIRMAN. Thank you very much. You have given us a very fine statement. I know it will be helpful to us. We appreciate your appearance.

Mr. SMALL. Thank you, Mr. Chairman.

The CHAIRMAN. We have some additional views on this legislation. Let me insert in the record these statements received from the National

Association of Mutual Savings Banks, the Conference of State Bank Supervisors, and the State of New York Department of Taxation and Finance.

(The information follows:)

STATEMENT OF NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

The National Association of Mutual Savings Banks requests that the provisions of this bill which prohibit state and local taxation of the intangible personal property of FDIC insured commercial banks be amended to also prohibit state and local taxation of the intangible personal property of FDIC insured mutual savings banks.

In this regard it is respectfully pointed out that such an amendment, extending the beneficial protection of the bill to all insured banks rather than merely to insured commercial banks, is consistent with the conclusions of the Board of Governors of the Federal Reserve System. The approach of the Federal Reserve Board on this issue was recently quoted by Chairman Frank Wille of the Federal Deposit Insurance Corporation, when, in testifying on the House version of this bill, he volunteered FDIC assistance in any redrafting of the bill approved by the House subcommittee. Chairman Wille quoted the Board of Governors as follows:<sup>1</sup>

"... In view of the declared Congressional policy of seeking equal treatment of State and national banks under State tax laws, and the close competition between banks and other depository institutions, it would be desirable that the restrictions proposed in our recommendations apply to all commercial banks (national and State) and all other depository institutions (savings banks, savings and loan associations, and credit unions)."

Chairman Wille went on to say:

"Title I of the Committee Print, however, would apply the restrictions proposed in the Board's recommendations only to insured commercial banks (national and State). Should your committee and the Congress decide that the Board's recommendation in this matter deserves implementation, the Corporation's staff stands ready to assist the subcommittee staff in redrafting Title I of the Committee Print so that the restrictions imposed therein would apply to all depository institutions."

A statement presented by Chairman Preston Martin of the Federal Home Loan Bank Board, before the same hearings of the Subcommittee on Bank Supervision and Insurance of the Committee on Banking and Currency of the House of Representatives fully supported the principle of amending the legislation to provide broadened protection from state and local taxation. In his statement Chairman Martin recommended that legislation relating to state taxation of federally insured banks, be extended to all federally insured depositories, "including mutual savings banks, savings and loan associations and credit unions".<sup>2</sup>

It was also noted by Senator Bennett, in his remarks when introducing this bill, that the Federal Reserve Board study made the recommendation that "measures should be taken to prevent discrimination between one class of banks and other business firms". Senator Bennett further stated that the Federal Reserve report had called attention to "dangers which might result from State taxation which might discriminate between national and State banks, between home State banks and out-of-State banks, between banks and other businesses generally, or between banks and other competing financial institutions".<sup>3</sup>

An illustrative situation where serious competitive inequities could result from enactment of the bill in its present form could be presented by the recently enacted Florida corporate income tax statute. Testimony by Mr. Ralph D. Turlington, Chairman on Finance and Taxation, Florida House of Representatives, at the recent House subcommittee hearings<sup>4</sup> on the House version of this bill made clear that Florida taxes the intangible personal property of certain corporations and opposes restriction of its capacity to do so. If this bill were passed in its present form, Florida and other states, denied authority to tax the income on

<sup>1</sup> Hearings before the Subcommittee on Bank Supervision and Insurance of the Committee on Banking and Currency, House of Representatives, Ninety Second Congress, Second Session, on Legislation To Provide For The State Taxation Of Insured Banks, Full Deposit Insurance, The Cashing Of Government Checks And Related Matters, June 19-20, 1972, p. 73.

<sup>2</sup> *Ibid.*, p. 83.

<sup>3</sup> Congressional Record, May 30, 1972, p. S8511.

<sup>4</sup> *Op. cit.*, p. 33.

the local mortgage loans held by out-of-state commercial banks, might well seek to tax such property of mutual savings banks and savings and loans. Quite apart from the impact of such a pattern of taxation on mutual savings banks and their depositors, the management of savings banks (which, for example, hold approximately \$1.7 billion in Florida mortgage loans) might well decide to curtail further mortgage lending in such jurisdiction.

An amendment and accompanying explanation which would serve to include mutual savings banks within the protections of Senate Bill S. 3652 are attached hereto.

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AMENDMENT TO PROPOSED SECTION 24(E) (1) FDIA, WHICH WOULD BE ADDED TO FDIA  
BY SECTION 1 OF S. 3652

Proposed Section 24(e) (1), FDIA, would be amended to read as follows:

“(e) Definitions.—For the purposes of this section:

“(1) ‘Insured bank’ means any institution organized under the laws of the United States, any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, or American Samoa—

“(i) which is a mutual savings bank as defined in Sec. 3(F) of this Act, the deposits in which are insured by the Federal Deposit Insurance Corporation, or

“(ii) which accepts deposits that the depositor has a legal right to withdraw on demand, engages in the business of making commercial loans, and the deposits in which are insured by the Federal Deposit Insurance Corporation.”

EXPLANATION OF PROPOSED AMENDMENT TO S. 3652

S. 3652 would, among other provisions, prohibit any state or political subdivision from imposing any tax on the intangible personal property owned by an insured bank. This restriction on state and local taxation, however, would only apply to the intangible personal property of those banks which (1) accept demand deposits, and (2) engage in the business of making commercial loans. This would effectively limit the benefits of the bill to commercial banks and would exclude mutual savings banks from such benefits. The exclusion of mutual savings banks from the benefits of the bill is accomplished by a special, restricted definition of “insured bank” to include only commercial banks. Everywhere else in the F.D.I.A. the definition of “insured bank” would continue to include mutual savings banks.

This amendment, which is consistent with the recommendation of the Board of Governors of the Federal Reserve System, and the Chairman of the Federal Home Loan Bank Board, and which reflects observations of the Chairman of the Federal Deposit Insurance Corporation in testimony before the House, would provide that whatever benefits are to be accorded by the bill should apply to *all* banks insured by FDIC, including mutual savings banks.

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CONFERENCE OF STATE BANK SUPERVISORS,  
*Washington, D.C., July 28, 1972.*

HON. JOHN SPARKMAN,  
*U.S. Senate,*  
*Washington, D.C.*

DEAR SENATOR SPARKMAN: Attached is a copy of the comments of the Conference of State Bank Supervisors (CSBS) with respect to S. 3652 which is before your Committee, and which deals with the question of state and local taxation of federally-insured commercial banks.

As state officials who supervise, as the primary examining authority, all State-chartered banks in the fifty States, Puerto Rico and the Virgin Islands, our regular members are pleased to submit these views on this matter of primary competitive importance to both state and national banks.

CSBS supports, as a matter of substance, the thrust of S. 3652 but believe this proposal represents an unnecessary, unneeded paternalism in derogation of States' rights in this area and should be rejected. We recommend, instead that the *Permanent* amendment of P. L. 91-156 as presently written be permitted to become effective January 1, 1973, as now scheduled. The provisions on the *Permanent* amendment of P. L. 91-156 give to each State, for the first time since 1864 an unfettered choice as to its tax policy with respect to both national and State

banks operating within its borders as long as both these classes of banks are treated alike. We believe that arguments against the implementation of the Permanent provisions in P. L. 91-156 represent in the final analysis an unwarranted expression of distrust of what State and local governments might do following the lifting of taxing restraints previously imposed upon them with respect to national banks.

Respectfully,

W. SMOOT BRIMHALL,  
Chairman, Federal Legislation Committee (Commissioner of Financial  
Institutions—Utah).

#### STATEMENT OF THE CONFERENCE OF STATE BANK SUPERVISORS

The Conference of State Bank Supervisors (CSBS) appreciates the opportunity to submit its views with respect to S. 3652 which relates to state taxation of federally insured commercial banks.

Our interest in this proposal, as well as in a somewhat similar measure, H.R. 15656 which is presently before the House Banking and Currency Committee, is based on the fact that the regular members of CSBS are the fifty-two State Bank Supervisors throughout our country. These state officials supervise, as the primary examining authority all State-chartered banks in the fifty States, Puerto Rico and the Virgin Islands. Commercial banks subject to this supervision number 9,578 and hold approximately 48 percent of the country's total commercial bank assets.

As supervisors of these State-chartered commercial banks we seek equality in the tax treatment accorded two groups of banking institutions offering essentially the same services to the public—one operating under a State charter, the other under a national grant. We also seek to leave to the individual State the authority to determine the method by which it taxes institutions operating within its borders, and the extent of such taxation.

The measures before the Congressional Banking Committees, S. 3652, and H.R. 15656, dealing with the question of state taxation of Federally insured commercial banks resulted from the passage on December 24, 1969, of Public Law 91-156, an Act "To Clarify the Liability of National Banks for Certain Taxes." The principal objective of P.L. 91-156 was to achieve equal treatment of state and national banks under tax laws determined by individual states. The Conference of State Bank Supervisors applauded passage of that Act amending legislation enacted approximately one hundred years ago that restricted the methods by which states could tax national banks, and which thus afforded a preferential treatment to national banks in this important competitive area.<sup>1</sup>

As signed into law December 24, 1969, the Act made a two-step revision of Section 5219 of the Revised Statutes governing taxation of national banks. Effective immediately upon its passage the bill's *Temporary* amendment granted authority for the home state to subject a national bank headquartered within its borders to any tax generally imposed on a nondiscriminatory basis throughout the taxing jurisdiction (other than an intangible personal property tax). It also provided for the imposition of certain taxes on a national bank that was headquartered out-of-State but doing business within the taxing state, if such taxes were imposed generally throughout such jurisdiction on a nondiscriminatory basis.<sup>2</sup>

The Act's *Permanent* amendment which is now scheduled to take effect January 1, 1973, would remove any restriction on State and local taxation of national banks and would provide that both national and state banks, wherever located, are to be treated alike for tax purposes.

At the time of passing P.L. 91-156 during December, 1969, the Congress requested the Federal Reserve Board to conduct a study to determine what, if any, legislation might be needed before the *Permanent* amendment took effect. The results of the Federal Reserve Board's study, together with the recommendations of the Board, were transmitted to the Congress during May, 1971. These recommendations, and back-up material, were published during June, 1972 as a Committee Print by the Senate Committee on Banking, Housing and Urban Affairs, entitled "State and Local Taxation of Banks," Parts I, II, III, and IV.

<sup>1</sup> Section 5219 Revised Statutes (12 U.S.C. 548).

<sup>2</sup> Sales and use taxes, taxes on real property, taxes on the execution, delivery, or recordation of documents, tangible personal property taxes, license, registration, transfer, excise, or other fees or taxes imposed on the ownership, use or transfer of tangible personal property.

Portions of S. 3652 are reflective of the recommendations contained in the Federal Reserve Board's study, e.g., (1) that intangible personal property of national banks remain exempt from State and local taxation and that this exemption be extended to State-chartered insured commercial banks; that certain limitations be placed on the imposition of "doing business" and similar taxes on out-of-State depositories, both national and State-chartered; and that measures be taken to protect against taxation that would discriminate unfairly against banks generally.

The Conference of State Supervisors agrees, as a matter of substance, with the thrust of these proposals.

We concur with respect to the undesirability of taxing the intangible personal property of an insured bank.

We concur that until the matter of the extent to which a State may tax foreign corporations doing business within its borders is clarified, it would be desirable to establish certain limits on the extent to which out-of-State insured banks may be taxed.

We also concur that protection should be provided against taxation that would discriminate unfairly against banks generally.

Having said the foregoing, however, we cannot accept the premise that the determination of taxes to be imposed by individual States be arrogated to the Federal government. That is the effect of S. 3652 which is before your Committee, as well as the effect of H. R. 15656, which is now under consideration by the House Banking and Currency Committee. Both measures in the final analysis, hold that State legislatures must be told by the Federal government that it is undesirable to tax intangibles of banks and that it is necessary to limit State legislatures in the area of taxation of out-of-State banks to those specific taxes enumerated in the pending legislation before both Congressional Banking and Currency Committees.

With respect to the proposal that the intangible personal property of national and Federally insured State-chartered commercial banks remain exempt from state and local taxation, it is particularly interesting to note the comments of the Federal Reserve Board released during June, 1972, on the "Impact on State and Local Government Revenues from the 1-Year Extension of the Prohibition of an Intangible Personal Property Tax for National Banks."<sup>3</sup> The Board stated:

"In no State are the intangible assets owned by State-chartered banks subject to *ad valorem* property tax. This undoubtedly reflects the continued prohibition of State and local taxation of the intangible personal property of national banks, since the States generally try to tax these two classes of banks alike . . ." (Page 608)

With respect to the likelihood of States imposing *ad valorem* taxes in the future on the intangible personal property of banks, should the taxing restrictions be removed from States, the Board stated:

"While there are a few intangibles-taxing States that over a longer period might consider the possibility of applying an intangibles tax to banks if that authority becomes available, the prospects appear remote that the tax would actually be adopted in the foreseeable future in more than a very few cases. Among most States which do not tax intangibles at the present time, views expressed by State tax officials indicate that there is little prospect that such a tax upon banks would even be considered." (Page 611)

It is the position of the Conference of State Bank Supervisors that State legislatures are competent to determine a sound, nondiscriminatory tax system, and that given the opportunity they will do so. We believe, therefore, that the proposal under consideration represents an unnecessary and unneeded paternalism in derogation of States' rights and should be rejected. We urge instead, that the Permanent section of P.L. 91-156 as presently written be enacted and that States be permitted to exercise their inherent right to tax institutions operating within their borders.<sup>4</sup> These provisions leave to each State and its localities choice of whether or not to tax banks operating within its borders, and if so, the method of such taxation.

The *Permanent* provisions of P.L. 91-156 give each State, for the first time since 1864 (when Section 5219 went into effect) an unfettered choice as to its

<sup>3</sup> Part IV, Committee Print dated June, 1972 issued by Senate Committee on Banking, Housing and Urban Affairs entitled "State and Local Taxation of Banks."

<sup>4</sup> Permanent amendment of Section 5219, Revised Statutes (a) Section 5219 of the Revised Statutes (12 U.S.C. 548) is amended to read:

"Sec. 5219. for the purposes of any tax law enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located.

tax policy with respect to all insured banks operating within its borders as long as both national and State banks are treated alike.

We believe that arguments against the implementation of such provisions represent in the final analysis an expression of distrust of what State and local governments might do following the lifting of taxing restraints previously imposed upon them with respect to national banks. It is our belief that the requirement that both national and State banks be treated alike for tax purposes is a sufficient assurance that they will be given even-handed, nondiscriminatory treatment at the State and local levels.

In summary, while we agree wholeheartedly with the objectives of S. 3652 which is before your Committee and H.R. 15656 which is before the House Banking Committee, with respect to the question of State taxation of Federally insured commercial banks, in the areas we have noted, we strongly believe that the State governments should be the implementing authorities with respect to this matter of primary competitive importance to both national and State banks.

STATE OF NEW YORK,  
DEPARTMENT OF TAXATION AND FINANCE,  
*Albany, N.Y., July 27, 1972.*

HON. JOHN SPARKMAN,  
*Senate Committee on Banking, Housing and Urban Affairs,  
New Senate Office Building, Washington, D.C.*

DEAR SENATOR SPARKMAN: The New York State Department of Taxation and Finance strongly objects to Senate Bill S. 3652, which we understand is scheduled to be considered by the Senate Committee on Banking, Housing and Urban Affairs on August 1 and 2.

S. 3652 is more restrictive than any other Federal legislation with respect to the taxation of banks. It requires unprecedented and impractical comparisons of the tax impact not only among state and national banks and other financial entities, but also between banks and general business corporations. It rejects existing classifications of businesses for state tax purposes. It denies the conclusion of the Federal Reserve Board, that, "In practice, it may be necessary in the interest of equity and economic neutrality to classify banks and other financial institutions, particularly depository institutions, separately from other businesses in order that tax provisions may be adjusted to their special characteristics."

S. 3652, in proposed section 24(d) (2) to the Federal Deposit Insurance Act, would disallow state taxes on state or Federally chartered banks which in any respect "discriminate" against any class of insured banks or general business corporations doing business within the state or any other form of monied capital competing with insured banks.

This provision incorrectly assumes that it is appropriate to classify financial institutions and business corporations in a group for all tax purposes. In so doing, it reverts to former S. 5219 requirements and even appears to broaden them by making the restrictions applicable to state chartered banks as well as national banks. It also fosters uncertainty, and controversy and impractical implementation and administration by the extremely broad statutory language setting forth the restrictions. Furthermore, based on New York State experience, there are no grounds for such restrictions.

These all encompassing guidelines for restrictions on state taxation do not reduce uncertainty for banks, but tend to increase it and to foster state bank taxation at least as high as general business corporations.

Another objection to S. 3652 is the requirement in proposed section 24(d) (3) which appears to mandate separate accounting for taxation of banks doing business in more than one jurisdiction. While separate accounting should be available for allocation of bank income, states should not be restricted to this one method since it could possibly work a hardship on taxpayers as well as the states.

Finally, New York objects to the passage of any such legislation upon which the states have not had a more adequate opportunity to be heard. S. 3652 was introduced on May 30, 1972, and not generally available until very recently. Furthermore, we understand S. 3652 does not reflect the approval of the Federal

Reserve Board and that a bill endorsed by them is currently under consideration by the House Committee on Banking and Currency. Thus, S. 3652 is premature.

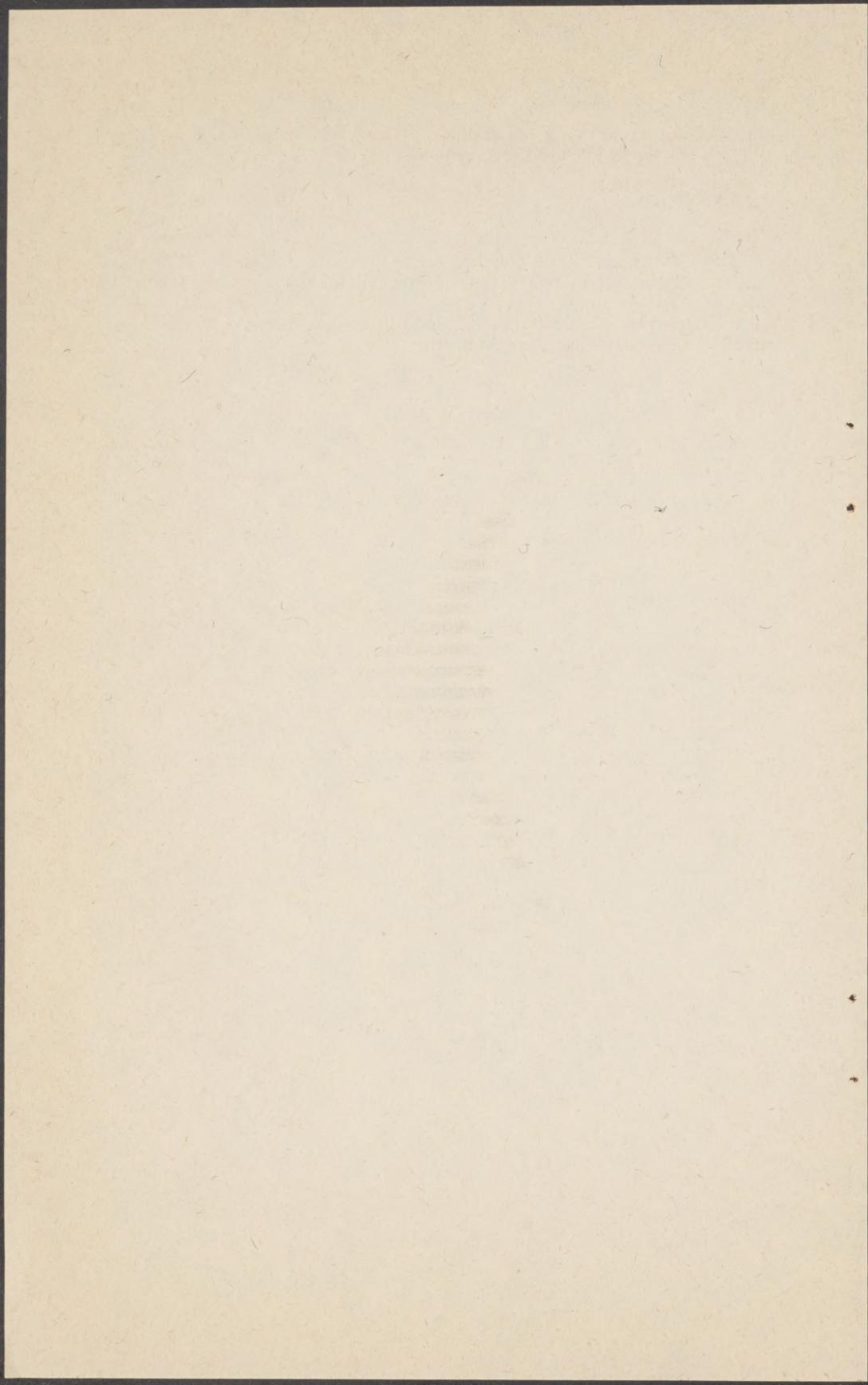
We urge its defeat.

Sincerely,

NORMAN GALLMAN,  
*Commissioner.*

The CHAIRMAN. This concludes the hearings for today. The committee will stand in recess until 10 o'clock in the morning when the hearings will resume.

(Whereupon, at 12:30 p.m. the committee was recessed, to reconvene at 10 a.m., Wednesday, August 2, 1972.)



## STATE AND LOCAL TAXATION OF INSURED BANKS

WEDNESDAY, AUGUST 2, 1972

U.S. SENATE,  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 10:07 a.m., pursuant to recess, in room 5302, New Senate Office Building, Senator John Sparkman, chairman of the committee, presiding.

The CHAIRMAN. Let the committee come to order, please. I hope some other Senators may be able to get here, but I am not certain. I suppose all of you know the Senate is already in session, and this is a very busy day. But I think we should proceed with the hearings and move along just as well as we can.

Of course, the transcripts will be available to all members, and I am sure they will read it. So I would like to get started.

And our first witness this morning is Frank Wille, Chairman of the Federal Deposit Insurance Corporation.

Mr. Wille, if you will come around, we will appreciate it very much. We are always glad to see you and compliment you on the good work you are doing.

### STATEMENT OF FRANK WILLE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. WILLE. Good morning, Mr. Chairman.

The CHAIRMAN. May I say to all of the witnesses prepared statements will be printed in full in the record, and you may present them as you see fit—read them, summarize them, discuss them, whatever you want to do. And that applies to you, Mr. Wille.

Mr. WILLE. Mr. Chairman, I would like to summarize certain parts of my statement and to dwell primarily on this issue of 100-percent insurance of public funds in insured banks.

The CHAIRMAN. That would be your task; would it not?

Mr. WILLE. Yes, sir, quite right. And that is why I would like to spend most of my time with a summary of the FDIC's position on that.

Now, with regard to this question of 100-percent insurance of public deposits, the Corporation has no knowledge as to the basis for the present proposal, but there was an assumption underlying a prior bill in the Congress to the effect that a number of public units had suffered substantial losses in bank failures throughout the country and that these Federal, State and local units of government had had to increase their taxes in order to recoup those losses. I am not going to enlist at this point the arguments for or against the proposal for 100-percent

insurance of public deposits, but I would state that that assumption was not then and does not appear today to be supported by the evidence.

The Corporation recently completed a study of public deposits recoveries and losses in the 56 banks which closed between January 1 of 1960 and year end 1971. That is for a full 12-year period.

These 56 banks had 341 public depositors with a total of almost \$55 million on deposit. As of year end 1971, the public units involved had recovered 99.2 percent or \$54.4 million of such deposits in one way or another. An additional \$343,000 has been or will be recovered through liquidating dividends paid or yet to be paid by the Corporation, thereby resulting in a total recovery of 99.8 percent of the funds on deposit at the time of failure and an estimated net loss of only \$115,809 to all public depositors in these 56 banks.

We believe this evidence clearly refutes the argument that a number of such public units have suffered substantial losses in cases where deposits were not secured or where the deposits of a closed bank were not assumed 100 percent by another institution.

It is possible that recovery of their deposits was delayed and a source of inconvenience to these public units, but we have no knowledge that Federal, State or local taxes had to be increased to recoup any losses resulting from bank failures.

Prior to my testimony last spring before the House committee considering a similar proposal, the Federal Deposit Insurance Corporation had traditionally taken a point of view opposed to 100-percent insurance of public funds. We reviewed our position shortly after I came to the Corporation, and we announced at that time that we would withdraw our past opposition to 100-percent insurance of public funds and would entertain no objection to the enactment of legislation along the lines of the proposal now before the committee in the form of Senator Proxmire's amendment.

We have assessed this matter from a very limited point of view which is that of the Corporation and its operations. And we have not been considering some of the other factors which bear on the issue of 100-percent insurance of public funds. We looked at the public deposits in these 56 banks, and we tried to figure out what would be our situation if in fact there had been 100-percent insurance of public funds.

We found that if we had had to make full payments—that is, 100-percent payments—outright to all public depositors in these 56 banks, the Corporation would have had to disperse additional funds of some \$27 million over those funds that we actually did disperse. And total recoveries to the Corporation through the liquidation of assets would have amounted to some \$19 million. These figures would produce an additional net estimated loss to the Corporation of approximately \$8 million for the 12-year period.

This study would tend to indicate that the deposit insurance fund would not be unduly burdened if legislation providing full insurance protection for these kinds of deposits were enacted.

Now, we do recognize that there are other issues that need to be carefully considered by the committee in reviewing this kind of a proposal. One of them has to do with the potential effects of enactment of 100-percent insurance on pledging requirements throughout the country.

A substantial majority of States require the pledging of securities by banks against the deposits of States and political subdivisions. And in large part, deposits of these governments are secured in turn by pledges of obligations of these same State and local governments.

To the extent that there is full insurance protection for public deposits, some States might be influenced to repeal these requirements for pledging, a factor which might induce some banks which are by far the largest holders of municipal securities to dispose of a portion of the municipal securities in their portfolios. This, in turn, might have a disruptive effect on State and local governments and their financing, since these units of government already have substantial difficulties in obtaining adequate financing for essential services.

It is also possible that the repeal of pledging requirements could result in investments that are contrary to the monetary policy being pursued at the time by the Federal Reserve Board.

Now, as I have previously indicated publicly, we have withdrawn our prior objection to the enactment of this type of legislation, and we no longer object to its enactment again from our particular point of view which is limited to that of the Corporation, its operations, and the integrity of the federal deposit insurance funds.

If I were to summarize our position with regard to this aspect of the legislation which is one of no objection, I would characterize it as one of neutrality rather than of full support. And the reason for that qualification is that we recognize that the proposal may have a disruptive effect on the market for State and municipal obligations if local pledging requirements are repealed.

We would urge in any event that if legislation providing 100-percent insurance of public funds is enacted that uniformity be required in the maximum interest rates payable on such deposits by commercial banks and by savings and loan associations.

I am not going to go into detail on the other two aspects of this bill. I will summarize our position with regard to the State taxation of national and State banks and also with regard to the check cashing provisions contained in Senator Proxmire's proposed amendment.

The Corporation supports the provisions of S. 3652 insofar as they reflect the recommendations of the board of governors of the Federal Reserve System as contained in its recent report submitted to the Congress pursuant to Public Law 91-156. To the extent the provisions of S. 3652 go beyond that report, for example, by requiring in-State banks to be treated for tax purposes on the same basis as business corporations generally and on the same basis as other financial institutions coming into competition with such banks, the Corporation would urge appropriate amendments to reinstate the Federal Reserve recommendations which do not go that far.

With regard to the check cashing provisions in Senator Proxmire's proposed amendment, we would urge that if the committee is considering the addition of those provisions to the current legislation they be modified so that insured banks and savings and loan associations are relieved of liability if they follow Treasury regulations for adequate identification, but nevertheless cash a Government check for the wrong person. This would be the same result which I understand applies today when U.S. savings bonds are cashed.

And with that, Mr. Chairman, I would conclude my remarks and hopefully I will be able to answer whatever questions you might want to direct to me.

The CHAIRMAN. Thank you very much, Mr. Wille. I hope to ask you one or two questions, and we will pass on.

You have proposed a couple of amendments to the Proxmire amendment, or maybe three. In your statement, you set forth two amendments, I believe.

One of them is to take care of the situation of banks.

And the other was savings and loan associations; is that right?

Mr. WILLE. Yes, sir; that is correct.

The CHAIRMAN. Now, later, is this another suggested amendment?

Mr. WILLE. It is an alternative suggestion, Mr. Chairman.

The CHAIRMAN. You mean to these two?

Mr. WILLIE. Yes. The latter suggestion would replace the last sentence contained in both previously proposed amendments.

The CHAIRMAN. I see.

Mr. WILLE. The reason for that is that we would recommend that the rates of interest which could be paid by banks and savings and loan associations on these public deposits be the same. The question is how do you achieve that uniformity when you have got three agencies that would be interested in setting interest rate ceilings. That is the Federal Reserve Board, the FDIC, and the Federal Home Loan Bank Board?

The CHAIRMAN. Do I understand that if the Proxmire proposal is amended in this way, you would favor it?

Mr. WILLE. We would not object to its enactment, sir.

The CHAIRMAN. You would not object?

Mr. WILLE. We would take a position of neutrality and say from our point of view, the Corporation—

The CHAIRMAN. What is your point of view if those amendments are not in there?

Mr. WILLE. Are not in there?

The CHAIRMAN. Yes, sir.

Mr. WILLE. If there is no requirement for uniformity between the different agencies as to interest rates to be paid?

The CHAIRMAN. Well, if it stands just as it is now without being amended.

Mr. WILLE. Then, I would say we would have to oppose it, sir, because I believe the uniformity of rate issue is a very important part of the proposal.

The CHAIRMAN. Let me ask you a question. Are public funds that are on deposit in a bank covered by FDIC insurance? Are they insured just like a private depositor's account up to the \$20,000 limit?

Mr. WILLIE. Yes, sir; they are. Each public depositor is covered separately for each account as we define the account up to \$20,000.

Now, this relates primarily to deposits that are not secured by pledges of securities against them. To the extent there is pledging of securities to cover the deposit, we pay back 100 percent of whatever amount is pledged, so that if the deposit is actually secured by a pledge which is the case in most States, the public body gets back 100 cents on the dollar right away.

The CHAIRMAN. If it is just an open deposit, it is insured just like a private deposit?

Mr. WILLE. That is right, sir.

The CHAIRMAN. And the banks do not pay any interest on these deposits, do they?

Mr. WILLE. They do on some, sir, and not on others. If the deposit is a demand deposit, a checking account for the public body, banks are prohibited by law from paying interest on the demand deposit.

On the other hand, if the deposit is a time deposit, yes, then banks may pay interest on that account. In fact, there is an active market bidding for municipal deposits in the time category. And they do pay interest on such deposits.

The CHAIRMAN. I was greatly interested in your figures that you gave.

Now, let me ask you this: Take in the case of the Bank of the Commonwealth of the City of Detroit, how much money would the city of Detroit have lost if that bank had failed?

Mr. WILLE. I can supply figures for the record, if you like. The total amount of public funds deposited in the Bank of the Commonwealth fluctuated considerably. To avoid estimates and to provide a breakdown, the figures will be as of yearend 1971, just prior to the time the Corporation announced its assistance program.

(Mr. Wille furnished the following information for the record:)

Bank of the Commonwealth was a significant depository, in excess of the insured limit, for the Detroit Board of Education and other local governmental bodies. As of year-end 1971, the State of Michigan had approximately \$28 million on deposit with the bank against which securities were pledged. Various governmental bodies had over \$135 million, in excess of the insured limit, on deposit with the bank against which no securities were pledged. The Detroit Board of Education alone had excess, unsecured deposits in the bank of nearly \$60 million.

I do not want to leave the impression that the various governmental bodies having unsecured funds, in excess of the insured limit, on deposit in the bank would have lost \$135 million had the bank failed. They would have had claims against the Corporation in its capacity as receiver of the bank—assuming the Corporation had been appointed receiver by the State chartering authority—and would have shared pro rata with any general creditors of the bank in any recoveries to the receiver resulting from liquidation of the bank's assets. Our recovery experience, as stated in my presentation, has generally averaged 99.8 percent of all public funds on deposit at the time a bank closes.

The CHAIRMAN. Well, thank you very much, Mr. Wille. We could go quite at length into the whole statement, but we have got quite a long list of witnesses.

Mr. WILLE. I know you do, sir, and I appreciate your courtesy.

The CHAIRMAN. I do want to ask you one more thing. And that is the question of compulsory cashing of checks from the Government. Did you express yourself on that?

Mr. WILLE. Yes, sir. I said that I thought the most important question here from the point of view of banks and savings and loan associations was what happens if they pay the wrong person even though they have tried to get adequate and complete identification.

As I understand it, when savings bonds are cashed, if the cashing institution follows the Treasury regulations for identification, but ends up paying the wrong person through no fault or negligence of their own, but maybe an outright forgery that they couldn't discover by

due care then the Treasury and not the cashing institution bears the risk of loss.

Now, there is not that kind of protection, as I read this bill, for banks cashing these Government checks. I think that is what banks are concerned about.

The CHAIRMAN. Well, the cashing of savings bonds, I believe, is a little more complicated procedure than just presenting a check to the bank. You have a form to fill out and data to give and so forth.

Mr. WILLE. Yes; it is more complicated when Series H bonds are presented, and there are probably fewer occasions when savings bonds would be presented. Even though it might be millions a year, it is still substantially less than the number of Government checks that would be cashed in a year's time. That is quite true.

The CHAIRMAN. Well, thank you very much, Mr. Wille. We do appreciate your appearance.

Mr. WILLE. Thank you, sir.

The CHAIRMAN. We will insert the full statement of the FDIC and also one from the General Counsel of the Treasury Department at this point in the record.

(The statements follow:)

STATEMENT OF FRANK WILLE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

OPENING REMARKS

I welcome the opportunity to appear before the Committee today to present the views of the Federal Deposit Insurance Corporation regarding S. 3652, 92d Congress, a bill "To clarify and regulate the powers of the States to tax commercial banks, to empower the States to tax national banks, to foster and promote the dual banking system by providing for equal State taxation of national and State banks, to promote the interstate flow of moneyed capital and the financial resources of insured banks, to foster and promote interstate and foreign commerce, and for other purposes," and Amendment No. 1364 thereto as submitted by Senator Proxmire on July 26, 1972.

STATE TAXATION OF INSURED BANKS

S. 3652 would amend the Federal Deposit Insurance Act to clarify further the principles governing State taxation of federally insured commercial banks.

Generally, the bill would authorize a State or political subdivision thereof, subject to prescribed limitations and restrictions, to impose on any insured commercial bank having a banking office within its boundaries (1) any taxes imposed on insured commercial banks on the date of enactment of the proposed amendment to the Federal Deposit Insurance Act and (2) any taxes imposed by legislation enacted after the date of enactment of the proposed amendment which are imposed on business corporations generally and which are imposed throughout the State or political subdivision on a uniform and nondiscriminatory basis. The authorization to continue existing taxes on insured commercial banks would not apply to taxes which are imposed in the same manner on insured commercial banks and business corporations generally and which are imposed at a higher rate upon banks than upon other corporations.

The bill would also authorize a State or political subdivision thereof, subject again to prescribed limitations and restrictions, to impose certain specified taxes of its own on any insured commercial bank not having a banking office within its boundaries, if such taxes are imposed generally throughout the taxing jurisdiction on a uniform and nondiscriminatory basis. For example, a State or political subdivision thereof could impose on an out-of-State bank (1) sales taxes and use taxes complementary thereto upon the purchase, sale, or use within the taxing jurisdiction of tangible personal property; (2) taxes on real property or on the occupancy of real property located within the taxing jurisdiction; (3) taxes (including documentary stamp taxes) on the execution, delivery,

or recordation of documents within the taxing jurisdiction; (4) taxes on tangible personal property located within the taxing jurisdiction; (5) license, registration, or transfer fees or other taxes imposed on the ownership, use, possession, or transfer within the taxing jurisdiction of tangible personal property (except fees or taxes based on gross receipts or net income); and (6) payroll taxes based on persons employed in the taxing jurisdiction.

In limiting and restricting the authority of States and their political subdivisions to tax insured commercial banks, the bill would prohibit the imposition of a tax on intangible personal property—a term which the bill would define as including mortgages; bonds; notes and other obligations; shares of stock; warrants; currency; coins, checks; credit cards; credit card accounts; funds on deposit at Federal Reserve banks, other banks, or elsewhere; and contracts, accounts receivable, judgments, and other similar documentary or other evidence of claims on others—owned by an insured commercial bank. It would not, however, prohibit a State or political subdivision thereof from taxing intangible personal property held by a bank in a fiduciary capacity to the beneficial owner thereof. Moreover, the bill would prohibit a State or political subdivision thereof from imposing, either directly or indirectly, any tax—

“ . . . upon any insured bank, or upon its shares, or upon its assets or liabilities, or upon or measured by its gross receipts or its net income, which, by reason of the base on which or rate at which it is assessed, by reason of the manner of its assessment or enforcement, or for any other reason would, by imposing a higher overall tax burden or in any other respect, discriminate against any class of insured banks as compared with any other class of insured banks, or against insured banks as compared with mercantile, manufacturing, and business corporations doing business within such State or political subdivision, or against insured banks as compared with other moneyed capital and other financial institutions coming into competition with insured banks in such State or political subdivision.”

Under those provisions of the bill which would authorize States to tax national banks, for the purposes of any tax imposed under the authority of the United States or any State, a national bank would be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located. The last section of the bill would repeal in its entirety the existing Federal statute—section 5219 of the Revised Statutes of the United States, as amended (12 U.S.C. 548)—which prescribes the manner in which State and local governments may tax national banks.

The bill is apparently designed to strengthen the principle of parity between State-chartered commercial banks and national banks with respect to State and local taxation, a principle which the Corporation has consistently supported. It is also designed to forestall some of the inequities and adverse economic consequences which might result if the so-called “permanent amendment” to section 5219 of the Revised Statutes were permitted to go into effect, as scheduled on December 31, 1972, without amendment. This “permanent amendment” now provides only that a national bank will be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located for the purposes of any tax law enacted under authority of the United States or any State.

For the most part, the changes in existing law proposed by the bill comport with recommendations of the Board of Governors of the Federal Reserve System, contained in its report to the Congress pursuant to section 4 of the Act of December 24, 1969 (Pub. L. No. 91-156; 83 Stat. 435), that, prior to December 31, 1972, the Congress enact legislation which would (1) continue to prohibit States and their political subdivisions from imposing taxes on intangible personal property owned by national banks and extend the prohibition to intangible personal property owned by State banks and other depository institutions such as savings banks, savings and loan associations, and credit unions; (2) limit the circumstances in which insured banks and other depository institutions are subject to taxes imposed by State and local governments on or measured by net income, gross receipts, or capital stock or to other “doing business” taxes in States other than those in which their principal offices are located; (3) prohibit the imposition of discriminatory or more onerous license, privilege, or other similar “doing business” taxes upon nondomiciliary depository institutions than might be imposed upon those institutions if they were chartered under the authority of the taxing jurisdiction; (4) permit States to include interest on obligations of the United States in determining the income of any bank or other depository institution for purposes of any tax which the States might otherwise be authorized to

impose; and (5) classify coins and paper currency as intangible personal property for the purposes of any tax imposed under the authority of any State or local government.

The Board of Governors' principal recommendation—that is, that intangible personal property of banks and other depository institutions be exempt from State and local taxes—is based upon its concern that, since virtually all of the assets of such institutions are in the form of intangibles, a general tax on intangibles would impose a heavier burden on banks and other depository institutions than on nonfinancial businesses. Moreover, the Board of Governors fears that a tax on intangible assets might cause banks and other depository institutions to reorganize their asset portfolios in the sense that they might be induced to divert funds from taxable to tax-exempt forms of assets—that is, from the financing of consumers and businesses, particularly local businesses, to the acquisition of Federal, State, and local obligations. The Corporation defers to the views of the Board of Governors on these matters in view of its special study and evaluation of the problem. For that reason, the Corporation would favor the enactment of those provisions of S. 3652 which would continue to deny to States and their political subdivisions authority to tax intangible personal property owned by national banks and which would extend that denial of authority, as well, to intangible personal property owned by any insured commercial bank.

The Board's second recommendation that the Congress enact legislation which would limit the circumstances in which insured banks and other depository institutions are subject to taxes imposed by State and local governments on or measured by net income, gross receipts, or capital stock or to other "doing business" taxes in States other than those in which their principal offices are located stems from the problems that might be involved in attempting to divide a fixed tax base between the State of a bank's principal office and other States in which the bank does business. The Board of Governors noted that, with interstate division of the tax base, there are no assurances that the sum of the taxable base on which two or more States levy taxes will not exceed 100 percent of the actual base. It also went on to note, however, that, even where the limit is not exceeded, serious burdens may result where two or more States use different methods for interstate division of the tax base and require different kinds of records and reports, with the result that, in some instances, the added costs of acquiring technical competence regarding differing tax laws and procedures of all States where a bank engages in business, maintaining records needed to determine which taxes are applicable and the amount of liability, and preparing and filing returns in all affected States may be even greater than the taxes.

In implementing the Board of Governors' second recommendation, S. 3652, by way of a "permanent amendment" to the Federal Deposit Insurance Act, would authorize a State other than a State in which an insured commercial bank maintains an office authorized to accept deposits and make commercial loans to impose only certain specified taxes—generally associated with real or tangible personal property owned by the bank or with certain transactions engaged in by the bank—on the out-of-State insured commercial bank. The Board's report, however, assumes that the problems associated with interstate division of a banks' tax base are not insurmountable, for it suggests the eventual enactment of Federal legislation which will (1) clearly define and circumscribe the circumstances in which taxes are applied to out-of-State institutions; (2) standardize, throughout the Nation, certain State procedures for applying taxes to out-of-State institutions; (3) establish uniform criteria for determining when a State or its political subdivisions may exercise jurisdiction to tax a bank or other depository institution which has its principal office or is chartered in another State; (4) establish uniform principles and procedures that will govern the interstate division of each type of applicable tax base in circumstances where the jurisdictional tests are met; and (5) establish uniform rules that will guide the States in their administrative procedures. Moreover, a bill (H.R. 15656) relating to State taxation of insured banks which currently is pending consideration before the House Committee on Banking and Currency makes a similar assumption, for its declaration of policy states, in pertinent part, that—

"... Application of taxes measured by income or receipts, or other 'doing business' taxes, in States outside the home State should be deferred until such time as uniform and equitable methods may be developed for determining jurisdiction to tax and for dividing the tax base among States."

Based on the assumption that the problem will receive additional study leading to the early enactment of legislation that will prevent nonuniform State

legislation or the taxation of more than 100 percent of the tax base of depositary institutions, the Corporation has no objection to the enactment, as an interim measure, of legislation along the lines suggested by the proposed section 24(c) of the Federal Deposit Insurance Act, under the terms of which a State other than the State in which a bank's principal office is located could impose only certain specified taxes on an out-of-State insured commercial bank. We strongly recommend, however, that either the legislative history of S. 3652, or a declaration of policy embodied in the bill itself, make clear the Congress' commitment to additional study of the problem and to the possible enactment of further legislation defining the authority of States and their political subdivisions to tax out-of-State banks.

The Board of Governors' third recommendation seeks to prohibit States and their political subdivisions from imposing heavier license, privilege, or other similar "doing business" taxes on out-of-State depositary institutions than on depositary institutions incorporated and existing under authority of the taxing jurisdiction or from discriminating between State and federally chartered institutions with respect to taxation. In the Corporation's view, it is essential that the Board of Governors' recommendation regarding nondiscriminatory taxation be acted upon if the Nation's dual banking system is to remain strong and viable and if depositary institutions are to be competitive and free from barriers to interstate credit operations. The language of the bill which purports to express the sense of the Congress on the issue of nondiscriminatory taxation, however, would prohibit discrimination with respect to taxation not only between different classes of banks—i.e., between home-State and out-of-State banks or between State and federally chartered banks—but also between banks and mercantile, manufacturing, and business corporations and between banks and other moneyed capital and financial institutions coming into competition with insured commercial banks. In this regard, the Corporation shares the Board of Governors' views that, because of their special functions and purposes, there may indeed be a basis for differentiating between depositary institutions and nonbank businesses with respect to taxation. For that reason, the Corporation recommends that the bill being considered by your Committee be amended so as to prohibit discrimination only with respect to taxation between different classes of depositary institutions and that it not address itself to the broader question of nondiscrimination between depositary institutions and nonbank businesses.

Regarding the Board's fourth recommendation, which S. 3652 would *not* implement, the Corporation respectfully defers to the views of the Department of the Treasury on the question whether a State, in determining the income of an insured commercial bank for tax purposes, should be authorized to include interest on obligations of the United States. The Corporation favors the enactment of those provisions of S. 3652 which would implement the Board's fifth recommendation, under the terms of which coins and paper currency would be considered intangible personal property for purposes of any tax imposed under the authority of any State or local government.

In my concluding remarks regarding S. 3652, I wish to note that, in its report to the Congress, the Board of Governors recommended that any additional Federal legislation dealing with State and local authority to tax national banks address itself to a larger group of financial intermediaries. Specifically, it stated that—

“ . . . In view of the declared Congressional policy of seeking equal treatment of State and national banks under State tax laws, and the close competition between banks and other depositary institutions, it would be desirable that the restrictions proposed in our recommendations apply to all commercial banks (national and State) and all other depositary institutions (savings banks, savings and loan associations, and credit unions).”

S. 3652, however, would apply the restrictions proposed in the Board's recommendations only to insured commercial banks (national and State). Should your Committee and the Congress decide that the Board's recommendation in this matter deserves implementation, the Corporation's staff stands ready to assist the Committee staff in redrafting S. 3652 so that the restrictions proposed therein would apply to all depositary institutions.

#### FULL DEPOSIT INSURANCE FOR PUBLIC UNITS

Among other things, Amendment No. 1364 to S. 3652 would amend the Federal Deposit Insurance Act and the National Housing Act to require the Corporation and the Federal Savings and Loan Insurance Corporation to insure

the deposits and accounts of public units for the full aggregate amount of such deposits or accounts, rather than to the maximum amount of \$20,000 currently provided for other depositors or share account holders. In the case of public units other than those of the United States, such insurance would be limited to the funds of public units within the State or territory in which the financial institution is located. The amendment would also permit the two agencies to limit the aggregate amount of public funds that could be deposited in insured banks or invested in institutions insured by the Federal Savings and Loan Insurance Corporation on the basis of the size of such banks or institutions in terms of their assets.

While the Corporation has no knowledge as to the basis for the present proposal, the assumption underlying an immediately preceding proposal for full insurance protection for public deposits or accounts—as embodied in sections 25 and 26 of H.R. 5700, 92d Congress—was that a number of public units had suffered substantial losses in bank failures throughout the country, with the result that Federal, State, and local governments had had to increase taxes to recoup these losses. Without at this point enlisting arguments for or against the proposal for 100 percent insurance of public deposits, the Corporation wishes only to state that the assumption was not then, and is not today, supported by the evidence.

The Corporation recently completed a study of public deposits, recoveries, and losses in the 56 banks which closed during the period from January 1, 1960 to December 31, 1971. Those 56 banks had 341 public depositors with a total of \$54,903,584.26 on deposit. As of year-end 1971, the public units involved had recovered 99.2 percent, or \$54,444,666.16, of such deposits in one way or another. An additional \$343,108.57 has been or will be recovered through liquidating dividends paid by the Corporation, thereby resulting in a total recovery of 99.8 percent of the funds on deposit at the time of failure and an estimated net loss of only \$115,809.53 to all public depositors in the 56 banks. We believe this evidence clearly refutes the argument that a number of such public units have suffered substantial losses in cases where deposits were not secured or where the deposits of a closed bank were not assumed 100 percent by another institution. It is possible, of course, that recovery of their deposits was delayed and a source of inconvenience. We have no knowledge, however, that Federal, State, or local taxes had to be increased to recoup any losses resulting from bank failures.

In reevaluating its position with respect to the enactment of legislation that would provide full insurance protection for public deposits, the Corporation believes that some of the arguments it has historically advanced in opposition to such proposals are no longer convincing. There is little evidence, for example, to support the argument that a system of limited insurance causes depositors (other than the largest ones) to select their depositories only after considering the management characteristics and capital adequacy of the various financial institutions immediately available to them or to support the argument that such a system imposes disciplinary restraint upon bankers who might otherwise succumb to presumed competitive or economic pressures which might develop as a result of the enactment of legislation providing full protection. Moreover, there may indeed be a basis for differentiating between public depositors and other depositors in determining the amount of insurance coverage that should be applicable to their deposits, since public deposits represent deposits by the taxpaying public, which has no direct voice in the selection of the depository.

In an effort to determine the impact that full insurance protection for deposits of public units might have upon the FDIC's deposit insurance fund, the Corporation, as a supplement to its recent study of public deposits, recoveries, and losses in the 56 banks which closed during the period from January 1, 1960 to December 31, 1971, estimated the additional disbursements, recoveries, and losses which would have resulted if 100 percent insurance for public deposits had been applicable during that same period. In arriving at our estimates, we assumed that States which now require the pledging of securities by banks against the deposits of States and political subdivisions would have repealed their pledging requirements, that full payments would have been made to all public depositors in the 56 closed banks during the period studied, and that the Corporation would have been subrogated to their rights against assets being liquidated. We found that the Corporation would have been required to disburse additional sums totaling \$27,016,716.94 and that total recoveries to the Corporation on account of such disbursements would have amounted to \$19,236,871.87. These figures produce an additional net estimated loss to the Corporation of \$7,779,845.07 for the 12-year period. The study would tend to indicate that the deposit insurance fund would

not be unduly burdened if legislation providing full insurance protection for deposits of public units were enacted.

The Corporation also recognizes that other issues, such as the potential effect the enactment of such legislation might have on pledging requirements, deserve careful consideration.

A majority of States require the pledging of securities by banks against the deposits of States and political subdivisions. Similarly, Federal statutes require that United States Government deposits in banks be secured by the pledge of Government obligations or certain other securities. In large part, deposits of State and local governments in States requiring the pledging of securities against those deposits are secured by obligations of State and local governments. To the extent that full insurance protection for public deposits might influence some States to repeal their pledging requirements, and to the extent that repealing those requirements might induce some banks—which are by far the largest holders of municipal securities—to dispose of a portion of the municipal securities in their portfolios, the enactment of legislation providing full insurance coverage for public deposits could have a disruptive impact on the market for obligations of State and local governments, many of which already are experiencing substantial difficulties in obtaining adequate financing for essential services. It is conceivable, also, that the alternative investments made with the funds freed by the repeal of pledging requirements could run counter to the monetary policy being pursued at the time by the Board of Governors of the Federal Reserve System.

Your Committee and the Congress are also likely to hear arguments that the enactment of legislation providing full insurance protection for deposits of public units would give savings and loan associations a competitive advantage over banks, since savings and loan associations have generally been permitted to pay higher rates of interest or dividends than banks have been permitted to pay and therefore would be able to attract more public deposits because of the differential. As your Committee knows, however, under their existing flexible interest-rate authority—pursuant to which different rates on different classes of deposits can be prescribed—the Corporation, the Board of Governors of the Federal Reserve System, and the Federal Home Loan Bank Board could act to “equalize” the rates paid by banks and savings and loan associations. In fact, these three agencies acted on June 23, 1970 to suspend all interest-rate ceilings on single maturity time deposits of \$100,000 or more with maturities of 30 through 89 days, thereby removing the differential insofar as deposits of that size and category are concerned. These arguments would be significant today, then, only if the public deposits were in different types of accounts or in amounts less than \$100,000 (or if the authority of the three agencies to set rate ceilings were permitted to expire or if the agencies adopted differing regulations).

After weighing all of these considerations, the Corporation—as I stated during my April 20, 1971 testimony before the House Committee on Banking and Currency regarding H.R. 5700, 92d Congress—wishes to withdraw its past objection to 100 percent insurance of public funds and to interpose no objection to the enactment of legislation along the lines proposed by Amendment No. 1364 to S. 3652. It strongly recommends, however, that the amendment be further amended so as to (1) require, with a view toward preserving the safety and soundness of insured institutions, that the aggregate amount of public funds that could be deposited in banks or invested in savings and loan associations be limited in relation to such criteria as liquidity, total deposit, and capital—rather than merely in relation to the size of a financial institution in terms of its assets—and further require that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations and (2) require that the maximum rates of interest on individuals payable on comparable deposits be the same for all insured banks and savings and loan associations.

One approach to implementing these recommendations would be amend the new subparagraph (2)(B) of section 11(a) of the Federal Deposit Insurance Act (12 U.S.C. 1821(a)), as would be added by Amendment No. 1364 to S. 3652, to read as follows:

“(B) Subparagraph (A) of this paragraph shall not become effective until such time as the Corporation shall, with the concurrence of the Federal Savings and Loan Insurance Corporation, issue regulations limiting the aggregate amount of funds that may be deposited in any insured bank by any person referred to in that subparagraph on any reasonable bases, such as the bank’s liquidity and capital structure and the types and amount of its assets and liabilities. In order that the maximum rates of interest or dividends payable on

such deposits by insured banks shall be the same as those payable on comparable accounts by federally insured savings and loan institutions, the Corporation, the Board of Governors of the Federal Reserve System, and the Federal Home Loan Bank Board shall consult with each other before issuing any regulations limiting such rates."

A companion amendment to the new subsection (d) (2) of section 405 of the National Housing Act (12 U.S.C. 1728), as would be added by Amendment No. 1364 to S. 3652, would read as follows:

"(2) Subparagraph (1) of this paragraph shall not become effective until such time as the Corporation shall, with the concurrence of the Federal Deposit Insurance Corporation, issue regulations limiting the aggregate amount of funds that may be invested in any insured institution by any person referred to in that subparagraph on any reasonable bases, such as the institution's liquidity and capital structure and the types and amount of its assets and liabilities. In order that the maximum rates of interest or dividends payable on such funds by insured savings and loan institutions shall be the same as those payable on comparable deposits by federally insured banks, the Federal Home Loan Bank Board, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation shall consult with each other before issuing any regulations limiting such rates."

We recognize, of course, that a requirement for mere consultation among the regulatory agencies may not actually achieve the goal of uniform interest-rate ceilings on deposits of public funds as between commercial banks and savings and loan institutions. This objective can be made clear by the Committee's Report, however, and we would expect from our experience with the consultation approach under existing interest-rate ceiling authority that the three agencies involved would, in fact, reach agreement on uniform rates.

If a more certain method of achieving uniformity were desired, we would suggest that the amendment's provisions be further amended to provide that a majority vote of the regulatory agencies involved would be sufficient to establish or change the ceiling rates on public funds. This approach could be implemented by amending the second sentences of both the above-quoted paragraphs to read as follows:

"The rate of interest or dividends paid on any such funds shall not exceed the rate permissible under regulations which shall be jointly issued from time to time by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board upon the concurrence of any two of such agencies."

#### HONORING CHECKS DRAWN UPON THE TREASURY OF THE UNITED STATES

Amendment No. 1364 to S. 3652 would also prohibit any insured bank or insured savings and loan association from (1) refusing to honor any check drawn upon the Treasury of the United States upon presentation of the check by the payee, together with adequate identification, on the ground that the payee does not maintain an account with such bank or association and (2) making any charge to the payee for honoring the check. The amendment would require the Secretary of the Treasury to prescribe regulations implementing the prohibition.

At the present time, no legal obligation is imposed upon insured financial institution to cash Government checks. Accordingly, the decision whether or not to cash Government checks, and, if so, under what circumstances, is entirely within the discretion of the management of financial institutions.

The Corporation wishes to point out that sections 360.4 and 360.5 of regulations prescribed by the Secretary of the Treasury (31 C.F.R. §§ 360.4 and 360.5 (1971)) provide, in effect, that the banks cashing Government checks assume the risk that the persons obtaining the cash are in fact the rightful owners and the persons named as payees. As a result, some banks are reluctant, without some corresponding return benefit, to bear the costs of handling and forwarding such checks for collection if they must also assume the risk of paying out cash to the wrong person. A bank will usually cash checks free of charge for depositors in the bank since mutual benefits are derived from a continuing deposit relationship and the risk of payment to the wrong person is, to some extent, minimized. A bank which cashes the checks of nondepositors, however, does not receive any such benefit and, at the same time, is subject to the above-mentioned costs and risk.

By way of contrast, the situation with respect to the payment of United States savings bonds is quite different. A memorandum of instructions issued in conjunction with Treasury Department Circular No. 750 states in pertinent part, for example, that—

“A financial institution which is a qualified paying agent is obliged to cash savings bonds and notes for any presenter, whether or not a customer, during its regular business hours. . . . Violation of the Department’s policy, as set forth above, will be cause for disqualification.” (Emphasis added)

The memorandum also recommends that certain identification procedures be followed by the paying agent in order to avoid liability for loss. Should the paying agent redeem a bond on a forged or unauthorized endorsement through no fault or negligence of its own, the Department of the Treasury will assume the loss (31 U.S.C. 757c(i) (1970) and 31 C.F.R. § 322.5 (1971)).

The Corporation believes that the same sort of conditions should apply to the cashing of Government checks. Since the provisions of Amendment No. 1364 would authorize the Secretary of the Treasury to prescribe implementing regulations as to the term “adequate identification,” the identification required for cashing savings bonds could be adopted for the cashing of Government checks. But a bank or savings and loan association which cashed a Government check would apparently still be required to assume the risk that the endorsement might be forged or unauthorized.

Accordingly, the Corporation recommends that any legislation enacted along the lines suggested by the “check cashing” provisions of Amendment No. 1364 should include a provision indicating that insured banks and savings and loan associations will not be held liable on Government checks bearing forged or unauthorized endorsements if there is no fault or negligence on their part—that is, if they follow the identification procedures required by Treasury regulations. If so amended, the Corporation would interpose no objection to the enactment of Amendment No. 1364.

#### SUMMARY

*To summarize:* (a) The Corporation supports the provisions of S. 3652 insofar as they reflect the recommendations of the Board of Governors of the Federal Reserve System as contained in its recent report submitted to the Congress pursuant to Pub. L. No. 91-156. To the extent the provisions of S. 3652 go beyond that report, e.g., by requiring in-State banks to be treated for tax purposes on the same basis as business corporations generally and on the same basis as other financial institutions coming into competition with such banks, the Corporation would urge appropriate amendments to reinstate the Federal Reserve recommendations.

(b) The Corporation has no objection to the concept of full insurance for public deposits insofar as the change may affect the operations of the Corporation or the exposure of the deposit insurance fund. The Corporation recognizes, however, that the proposal may have a disruptive impact on the market for State and municipal obligations if local pledging requirements are repealed and urges amendments in any event that would require uniformity in the maximum rates payable on such deposits by banks and savings and loan associations.

(c) The Corporation recommends that the “check cashing” provisions of Amendment No. 1364 be modified so that insured banks and savings and loan associations are relieved of liability if they follow Treasury regulations for adequate identification but nevertheless cash a Government check for the wrong person—the result which applies today when United States savings bonds are cashed.

THE GENERAL COUNSEL OF THE TREASURY,  
*Washington, D.C., August 8, 1972.*

HON. JOHN SPARKMAN,  
*Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate,  
Washington, D.C.*

DEAR MR. CHAIRMAN: The attention of this Department has been called to Amendment No. 1364 to S. 3652, “To clarify and regulate the powers of the States to tax commercial banks, to empower the States to tax national banks, to foster and promote the dual banking system by providing for equal State taxation of national and State banks, to promote the interstate flow of moneyed capital and the financial resources of insured banks, to foster and promote interstate and foreign commerce, and for other purposes.”

Title II of the Amendment would (1) require Federally insured institutions to honor any check drawn upon the Treasury of the United States, even though the payee does not maintain an account with the institution, if the payee

presents adequate identification, and (2) prohibit such institutions from making a charge to the payee for honoring such a check. It would authorize the Secretary of the Treasury to prescribe regulations necessary or appropriate to effectuate this Title.

In respect to Title II we do envision problems that could be encountered by small financial institutions that by reason of their location might be called upon to cash large numbers of Treasury checks. The risk and expense of maintaining large amounts of cash on hand and the cost of additional personnel that might be required could, in specific instances, involve unreasonable burdens on such institutions. We contemplate, therefore, that the Treasury regulations issued to effectuate this title would permit specific institutions faced with such problems to request authority to limit the number of checks cashed for non-customers. We believe that this and other problems that might arise in the future could be covered in the Treasury regulations and hence we see no need to amend the language in the bill. The Treasury has, therefore, no objection to this Title.

Title III of the Amendment relates to full deposit insurance for public units. Generally, State laws limit the amount a public unit may deposit in commercial banks and savings and loan associations to the amount of FDIC or FSLIC insurance, and permit banks, but not savings and loan associations, to accept deposits beyond the amount of insurance coverage if the bank gives security for such deposits. Title III would amend the Federal Deposit Insurance Act and Title IV of the National Housing Act to provide 100 percent insurance for deposits of public units in institutions insured by the Federal Deposit Insurance Corporation and Federal Savings and Loan Insurance Companies.

The Department is opposed to Title III. Exempting such depositors from insurance limitations would appear to conflict with the objectives under existing law of providing protection for the savings of individuals and families of moderate means who frequently lack the technical ability to appraise accurately the soundness of available outlets for their funds, while maintaining the incentive to holders of large accounts to investigate institutions before placing deposits in them. Limiting deposit insurance to small accounts also provides an incentive for good management of depository institutions in order to attract large deposits. Moreover, exempting one class of depositors from the limitations on insurance coverage could lead to pressures to extend the exemption to other classes. The President's Commission on Financial Structure considered but rejected 100 percent deposit insurance coverage for much the same reasons.

Furthermore, we question the appropriateness of Federal legislation to deal with problems arising from State laws which limit public deposits to Federally-insured amounts and State laws which permit banks, but not savings and loan associations, to provide collateral security for public deposits in excess of Federally-insured amounts. If these States wished to place more deposits with savings and loan associations, they presumably would change their own laws so as to place savings and loan associations on the same footing with banks.

Moreover, Title III could also result in an increase in the borrowing costs of the Treasury, other Federal agencies, and State and local governments. Commercial banks now hold about \$170 billion of Treasury, agency, and municipal obligations, part of which are used as collateral security for public deposits which are not insured. Thus increased insurance of public deposits could result in higher interest rates on Treasury, agency, and municipal obligations because of reduced bank demand for such obligations.

The Department has been advised by the Office of Management and Budget that there is no objection, from the standpoint of the Administration's program, to the submission of this report to your Committee.

Sincerely yours,

SAMUEL R. PIERCE, JR.,  
General Counsel.

The CHAIRMAN. Our next witness is Mr. Robert Bloom, Chief Counsel of the Office of the Comptroller of the Currency.

Mr. Bloom, we would be very glad to hear from you. We welcome you back.

STATEMENT OF ROBERT BLOOM, CHIEF COUNSEL, OFFICE OF THE  
COMPTROLLER OF THE CURRENCY

Mr. BLOOM. Thank you, Chairman Sparkman.

My statement is quite brief, and I think perhaps the most expeditious thing I could do is read it rather than try to summarize it, sir.

The CHAIRMAN. All right, sir.

Mr. BLOOM. The Comptroller of the Currency and Treasury Department favor continuation of the policy adopted by the Congress in 1969 of complete equality of treatment between State-chartered and national banks with regard to State taxation. Both S. 3562 and title II of H.R. 15656 provide this complete equality of treatment, but impose restrictions on the States with regard to collecting two types of taxes from any bank. The language of either bill is acceptable to our office. However, we believe that the wording of H.R. 15656 is somewhat less susceptible to the creating of questions of interpretation.

Unless one or the other of the bills is enacted prior to the end of this year, the "permanent amendment" of section 5219 will become effective on January 1, 1973. If that provision is permitted to go into effect without revision, there will thereafter be no Federal statutory restrictions of any kind on the power of States and their subdivisions to impose taxes on insured banks.

The Congress in enacting Public Law 91-156 in 1969 was concerned over possible unforeseen consequences of this substantial change in preexisting law and requested that the Board of Governors of the Federal Reserve System make a study to determine the probable impact on the banking systems and other economic effects of the change and also requested that the Federal Reserve study include recommendations as to any additional Federal legislation which might be needed on the subject. The Board, in response to this request, made an exhaustive study which has been printed and is before the committee, of course.

The Board's conclusions and recommendations dated May 1971, were that the permanent amendment of Public Law 91-156 should not be permitted to go into effect without revision. The Board concluded that if this were allowed, the changed tax status of banks could open the way for State and local tax measures which, to quote the report, "could impair the ability of the banking system and possibly the entire structure of financial intermediaries to contribute to the efficient allocation of the Nation's credit resources."

The Board recommended that restrictions be continued on the powers of States and local governments to collect two types of taxes:

1. Taxes on intangible personal property.
2. "Doing business" taxes imposed by States other than the State of the home office of the institution.

The reasons for the Board's recommendations are clearly and persuasively set forth in their report. I shall only briefly summarize them here. The case for prohibition of ad valorem taxes on intangible personal property of banks is set forth on pages 2, 3, and 4 of the report. The Board points out that a general tax on intangibles would bear with much greater weight on banks and other depository institutions than on nonfinancial businesses.

Virtually all the assets of such institutions are in the form of intangibles, whereas this type of property is much less important for

nonfinancial firms. Banks are closely regulated and supervised with published balance sheets; the tax assessors are therefore unlikely to undervalue fixed claims such as bank assets to the degree that they can and generally do undervalue other types of assets.

However equal the treatment provided in the tax law, in practice, depository institutions would be at a marked disadvantage compared with businesses and individuals, particularly where intangibles are blanketed into a general property tax that purports to apply the same evaluation standards and rates to all types of tangible and intangible personal property.

An intangibles tax applied to banks would have a number of adverse economic consequences depending in magnitude on the level and geographic extent of the tax. The principal effect would be an impairment of the ability of such financial intermediaries to gather in savings and allocate funds for productive investment.

The process of financial intermediation performed by banks is particularly vulnerable to an intangibles tax since the duplication of financial assets that is inherent in the flow of savings, first into deposits and then into deposits and then into customer loans, would expose savings flowing through intermediaries to an additional layer of taxation not encountered where funds flow directly from savers to ultimate borrowers.

A tax on intangible assets would tend to induce banks to divert funds from taxable to tax exempt forms of assets; that is, from financing for consumers and businesses to acquisition of Federal, State, and local obligations.

Second, the Board recommended and these bills embody a limitation on taxation by States other than the State of the principal office. The bills would permit such other States to collect the following forms of taxes from out-of-State banks which may be doing some business within the collecting States' borders:

1. Sales and use taxes upon purchase, sales, or use of tangible personal property within such jurisdictions;
2. Taxes on real estate or on the occupancy of real estate located within such jurisdiction;
3. Taxes on the execution, delivery, or recording of documents within such jurisdiction;
4. Ad valorem taxes on tangible personal property located within the jurisdiction;
5. License registration transfer, excise or other fees, except those based on gross receipts or net incomes, imposed on the ownership use or transfer of tangible personal property located within the jurisdiction; and
6. Payroll taxes based on persons employed in the jurisdiction.

The bills would prohibit nondomiciliary States from collecting taxes measured by income or receipts or other so-called doing business taxes. Section 207(a) of H.R. 15656 would direct the Board of Governors to study further the question of the application of State doing business taxes on out-of-State insured commercial banks and to make recommendations for legislation which would provide equitable State taxation of out-of-State insured commercial banks. We understand, however, that the Board does not believe that it is the appropriate agency to make such recommendations.

The reasons for the limitation on doing business taxes by nondomiciliary States are stated on pages 4, 5, and 6 of the Board's report. In the absence of some Federal standard under which States are required to divide the tax base, there is no assurance that the sum of the taxes which two or more States may levy will not exceed 100 percent of the actual base.

Even where this limit is not exceeded, serious burdens result when two or more States claim jurisdiction to tax, for example, the same net income, using different rules for interstate division of the tax base and requiring different kinds of records and reports.

The added cost of acquiring technical competence regarding the differing tax laws and procedures over all States where business is done, maintaining the records needed to determine which taxes are applicable and the amount of liability, and preparing and filing the returns in all affected States may be even greater than the taxes.

In addition to the importance of avoiding overtaxation of any given tax base, it is equally important to avoid excessive compliance costs and the erection of barriers to interstate credit flows. Such barriers would be raised not only by the taxes themselves, but also if there insured uncertainty, controversy, and litigation of the sort that for decades have characterized taxation of interstate mercantile and manufacturing businesses. Uncertainties about potential tax liabilities and concern about compliance burdens could become material factors in decisions to make particular loans or investments.

The imposition of income or other doing business taxes would tend to induce out-of-State lenders to divert credit flows away from States imposing such taxes and into States with a favorable tax climate or into marketable securities.

The Board's conclusion, with which we agree, is that the nondomiciliary State's power to impose income or other doing business levies, should be suspended until such time as a formula can be devised for the fair allocation of such taxes among States.

The Comptroller of the Currency fully supports the recommendations of the Board of Governors of the Federal Reserve as embodied in title II of H.R. 15656 and S. 3562.

That concludes.

The CHAIRMAN. Thank you very much, Mr. Bloom.

Let me ask you just one or two questions. Do I understand correctly now that you go along—when I say “you,” I mean your office, your organization—completely with the Federal Reserve Board's recommendations?

Mr. BLOOM. That is correct.

The CHAIRMAN. In all respects?

Mr. BLOOM. Yes, sir.

The CHAIRMAN. Now suppose—

Mr. BLOOM. May I qualify on one point which is not involved in any of the bills? And that is this question of interest on Federal obligations. One of the Board's recommendations was that States be permitted to tax such interest. That proposal is not embodied in either bill as I understand it. It is not under active consideration.

The CHAIRMAN. I think that is right. Certainly, we understand your position on that.

Now, if legislation is not enacted placing limits on the rights of States to tax insured banks as contained in S. 3652, do you anticipate that States would rush to impose new taxes on banks? Do you think that or do you think the States would act in a reasonable and moderate manner? Or do you think they might act immoderately?

Mr. BLOOM. Mr. Chairman, I have no reason to believe they would act in anything, but a responsible manner. However, I do as a lawyer fear that there would ensue a long period of tremendous uncertainty over the powers of States to impose taxes on certain volumes of activity within a particular State and various types of activity within a particular State.

And I think that although I have no aversion to more work for my profession, I am afraid that the resulting period of uncertainty, of legal uncertainty, would have a very detrimental effect on the continued growth of our banking system and its especially moving into new areas of activity. And I do not think that the merit of permitting that to happen would outweigh the detriment involved.

The CHAIRMAN. Do you have any comment on two other provisions in the Proxmire proposal? One is the required cashing of Government checks, and second the proposal of 100-percent insurance of publicly deposited funds.

Mr. BLOOM. On the 100-percent insurance of public funds, Mr. Camp testified sometime ago on a similar proposal in opposition to that concept, mainly on the basis of the possible disruption of the municipal bond market. And he has not changed his feeling on that.

The CHAIRMAN. By the way, he is a member of the Federal Deposit Insurance Board; is he not?

Mr. BLOOM. Yes, sir.

The CHAIRMAN. Now, what about it?

Mr. BLOOM. Check cashing?

The CHAIRMAN. Check cashing.

Mr. BLOOM. I made some efforts yesterday to get an official Treasury position on that, Mr. Chairman, but I was not successful. That is an area which is completely outside the Comptroller of the Currency, and I would have—

The CHAIRMAN. I realize that.

Mr. BLOOM (continuing). To pass on that one until one of the assistant secretaries could be contacted on that.

The CHAIRMAN. Am I correct in feeling that your recommendation and the recommendation of the Federal Reserve Board, in effect, is to enact legislation that would augment certain standard taxation forms of States, but hold off on certain kinds you discussed until the proper allocation may be worked out among the States?

Mr. BLOOM. Yes, sir. To my knowledge, this legislation coupled with the expiration of the temporary bill in which would result in States being able to tax banks with complete freedom from Federal interference with the exception of these two areas of taxation:

One. The ad valorem tax on intangible assets—loans, securities, et cetera.

And, two. This doing business area. That one is a little broader in concept. However, it does have a fairly definite outline in the tax law.

What we are talking about there are taxes measured by the net income, capital stock, gross receipts or some other tax base properly

apportioned or allocated to the particular State. But there has been a tremendous amount of writing and litigation about what constitutes the proper allocation of a given corporation's tax base to a particular State.

Now, in the nonbanking business over the years, this has resulted in some progress. There is one Federal statute, Public Law 86-272, which prohibits a State from imposing a doing business tax on a corporation which merely solicits orders for tangible property within a State. But that statute does not apply to banks.

Similarly, you have interstate compacts and the Uniform Division of Income for Tax Purposes Act which has been agreed to by about two-thirds of the States which have made a great deal of progress in handling the problem for a nonbank corporation. But because the banks were considered substantially out of this problem up to now, there has not been a comparable progress made in assuring an equitable method of allocating the base to States other than the home State.

So that if the thing were opened up now as would happen if these bills, one or the other of these bills, is adopted, there would be a tremendous period of confusion and uncertainty as to just how the prior compacts dealing with nonbanking business can be extended to the banking and financial area. In other words, there has not been the progress made in interstate taxation of banking that there has been in these other areas.

So it is doubly important, I think, that it not be opened up without a Federal method of allocation being prescribed.

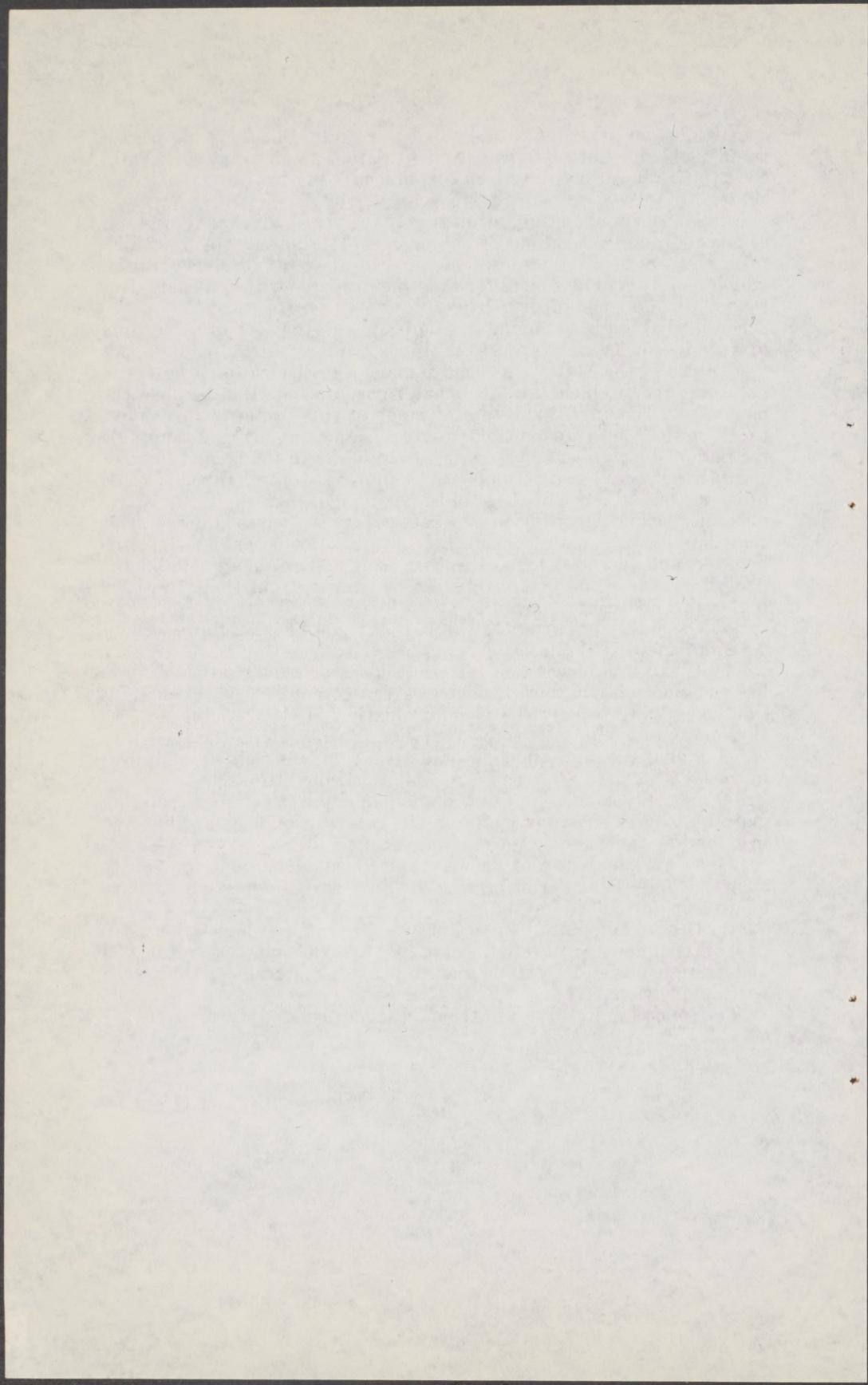
The CHAIRMAN. I want to ask you a question that I do not believe has come out clearly, but do I understand correctly that this legislation embodying largely the recommendation of the Federal Reserve Board would enable States to tax national banks along the lines provided, and at the same time it would extend the restrictions contained in the legislation to State banks as well as national banks.

Let me ask you as a lawyer and one particularly versed in banking matters, to give me your views on the constitutional issues involved in extending these restrictions to State banks.

If you are not ready to answer that, I would be glad for you to answer it in writing for us because I think that is a question we have got to take into consideration.

Mr. BLOOM. Yes, sir. I know the intention of the legislation is to provide complete equality in the exposure to taxation between National and State banks and I will be glad to provide material for the record on this question.

(The following was received from the Comptroller of the Currency:)





THE ADMINISTRATOR OF NATIONAL BANKS

WASHINGTON, D.C. 20220

Office of the  
Comptroller of the Currency

August 3, 1972

Mr. Reginald Barnes  
Senate Banking Staff  
Suite 5300  
New Senate Office Building  
Washington, D. C. 20510

Dear Mr. Barnes:

I am returning herewith the corrected transcript of my testimony of August 2, 1972 on S. 3562.

I have also enclosed copies of an article which appeared in the April 1972 issue of the Banking Law Journal entitled "Congressional Authority to Regulate the State Taxation of State Banks - the Federal Reserve's Recommendations for an Alternative to PL-156." This article contains a good discussion of the question which I understand Chairman Sparkman to have directed to me at the end of my testimony. We agree with the conclusion of the writer of the Article that Congress does possess the authority under the United States Constitution to regulate state taxation of state banks.

Sincerely yours,

Robert Bloom  
Chief Counsel

Enclosures

**CONGRESSIONAL AUTHORITY TO REGULATE  
THE STATE TAXATION OF STATE BANKS—  
THE FEDERAL RESERVE'S RECOMMENDATIONS  
FOR AN ALTERNATIVE TO PL-156**

by Geoffrey B. Shields\*

**Background**

*Instrumentality Cases*

In 1967 the highest courts in Massachusetts<sup>1</sup> and New York<sup>2</sup> ruled that national banks are not protected from nondiscriminatory state taxation by the doctrine of implied intergovernmental immunity. On June 17, 1968, the United States Supreme Court reversed the Massachusetts Supreme Judicial Court's decision.<sup>3</sup> The United States Supreme Court was pressed to decide the constitutional question of whether national banks can still be viewed as "federal instrumentalities" in light of changed circumstances. The Court, however, expressly declined to undertake a constitutional analysis and instead premised its decision upon the provisions of the National Bank Act which, it held, implicitly denied states the power to levy taxes which are not expressly permitted.

**PL-156**

The Supreme Court's decision brought a wave of requests to the Congress from state officials. They wanted

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\* Mr. Shields is a third-year student at the Yale Law School, and member of YALE LAW JOURNAL.

<sup>1</sup> First Agricultural National Bank v. State Tax Commission, 229 N.E.2d 245 (Mass. 1967).

<sup>2</sup> Liberty National Bank & Trust Co. v. Buscaglia; 21 N.Y.2d 357, 235 N.E.2d 101, 288 N.Y.S.2d 33 (1967), *rev'd*, 298 N.Y.S.2d 513 (1969). The New York Court after rejecting the federal instrumentality doctrine, later reversed itself in line with the Supreme Court's decision in the Massachusetts case.

<sup>3</sup> First Agricultural National Bank v. State Tax Commissioner, 392 U.S. 339; 88 S.Ct. 2173 (1968).

Congress to amend Section 5219 of the Revised Statutes (12 U.S.C. 548) to allow states to impose on national banks all the types of taxes which they presently levy on state chartered banks.<sup>4</sup> After extensive hearings,<sup>5</sup> the Congress adopted PL 91-156. Section 2 of PL 91-156 reads as follows:

2. Permanent amendment of Section 5219, Revised Statutes.  
 (a) Section 5219 of the Revised Statutes (12 U.S.C. 548) is amended to read:

"Sec. 5219. For the purposes of any tax law enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located."

(b) The amendment made by subsection (a) becomes effective on January 1, 1972.

Section 4 of PL 91-156 commissioned the Board of Governors of the Federal Reserve System to study the probable economic impact of the changes in existing law made by Section 2 and to recommend possible changes in the law.

#### *Federal Reserve Board Study*

The subsequent Federal Reserve Board study recommended that Section 2 of PL 91-156 not be allowed to take effect and that instead the Congress adopt legislation which would except national *and* state banks from certain types of state taxation.<sup>6</sup> In essence the Federal Reserve Board

<sup>4</sup> For legislative history of PL 91-156 which amends Section 5219, see 91st Congress, First Session, U.S. Code and Administrative News, 1594. *Also see:* HEARINGS ON S.2065, S.2906, AND H.R. 7491 BEFORE THE COMMITTEE ON BANKING AND CURRENCY, United States Senate, 91st Cong., First Session (1969).

<sup>5</sup> *Id.*

<sup>6</sup> *See:* Part One, STATE AND LOCAL TAXATION OF BANKS, REPORT OF A STUDY UNDER PUBLIC LAW 91-156 PREPARED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, UNITED STATES SENATE, 92d Congress, 1st Session (1971). (Henceforth cited as FED. RES. STUDY.)

agreed with the goal of 91-156 that national and state banks should be taxed at the same rate, but suggested that Congress achieve this goal by exempting *both* state and national banks from certain types of state taxation *rather than* by requiring only that states tax national and state banks at the same rate.

The Federal Reserve Board study assumed the basis for the Congressional authority to tax state banks with this brief comment:

“There appear to be no constitutional inhibitions with respect to congressional authority to intervene with respect to State taxation of financial institutions.”<sup>7</sup>

This assumption by the Federal Reserve Board is very significant since it would allow the United States Congress to regulate state taxation of state banks, an activity heretofore conducted by the states themselves. Moreover, if

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The five recommendations are:

Recommendation 1. Intangible personal property: Continue without time limit the present denial of authority for states and their subdivisions to impose taxes on intangible personal property owned by national banks and extend that denial to intangible personal property owned by state banks and other depository institutions.

Recommendation 2: Taxation by states other than the state of the principal office: Limit the circumstances in which national banks, state banks, and other depository institutions may be subject to state or local government taxes on or measured by net income, gross receipts, or capital stock, or to other “doing business” taxes in a state other than the state of the principal office, and prescribe rules for such taxation.

Recommendation 3. Discriminatory taxation: Proscribe the imposition of discriminatory or more onerous licenses, privilege, or other similar “doing business” taxes upon out-of-state depository institutions than would be imposed upon those institutions if chartered by the taxing state. The provision might take the form of a specific limitation, under which an out-of-state corporation or association could not be required to pay a higher license, privilege, or other “doing business” tax or fee than it would pay under the same circumstances if it were domiciled or chartered in the taxing state.

Recommendation 4. Interest in federal obligations: Amend the federal public debt statutes to authorize states to include, in the measure of otherwise valid direct net income taxes, the income realized by banks and other depository institutions from federal government obligations.

Recommendation 5. Classification of coins and currency: Establish, by statute, a nationwide value that coins and paper currency are to be considered intangible personal property for state and local tax purposes.

<sup>7</sup> FED. RES. STUDY, *supra*, note 6 at 56.

Congress is to regulate state taxation of banks, there would be a strong precedent for direct Congressional regulations of state banks, perhaps even a precedent for a requirement that all state banks join the Federal Reserve System or that all state banks become national banks.

#### *Congressional Authority to Regulate State Banks*

The purpose of this article is to explain the source of the Congressional authority to regulate state banks. It is by conclusion that the United States Congress has the authority under the Constitution not only to prohibit certain types of state taxation of state banks, but also to require state banks to join the Federal Reserve System or to become national banks.

The authority of Congress to regulate state banks comes primarily from the Commerce Clause.<sup>8</sup> Secondary sources of authority may lie in the power of Congress to borrow money on the credit of the United States<sup>9</sup> and the power of Congress to regulate the value of money.<sup>10</sup>

On the other hand, it is my conclusion that Congress probably does *not* have the authority to bar state taxation of state banks under the theory that all banks, including state banks, are instrumentalities of the federal government.<sup>11</sup>

I will deal first with the instrumentality theory.

<sup>8</sup> U.S.C.A. Const. Art. 1 § 8cl. 3. See: Emmette Redford, *Dual Banking: A Case Study in Federalism*, 31 LAW AND CONTEMPORARY PROBLEMS 749, 753 (1966).

<sup>9</sup> U.S.C.A. Const., Art. 1, § 8, cl.2.

<sup>10</sup> U.S.C.A. Const., Art. 1, § 8, cl.5.

<sup>11</sup> Congress has the power to protect its instrumentalities from state taxation under U.S.C.A. Const. Art. 1, § 8, cl. 18: "Congress has the power to make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Office thereof."

See: *Pittman v. Home Owner's Loan Corporation*, 308 U.S. 21, 60 S. Ct. 15 (1939); *United States v. Swain County, N.C.*, 46 F.2d 99 (1930); *Federal Land Bank of St. Paul v. Bismark Lumber Co.*, 314 U.S. 95, 62 S. Ct. 1 (1941); *United States v. Wright*, 53 F.2d (4th Cir. 1931); *First Agricultural National Bank v. State Tax Com'n*, 229 N.E.2d 245 (Mass. 1967).

*State Banks Are Not Instrumentalities of the Federal Government*

Before discussing the scope of the Commerce Clause, I will briefly discuss the scope of the federal government instrumentality tax immunity doctrine. The *First Agricultural* case lists the various formulations the United States Supreme Court has used to determine whether institutions are exempt from state and local taxation as government instrumentalities.<sup>12</sup> All of the formulae indicate that for an in-

<sup>12</sup> 392 U.S. 339, at 353, 354; 88 S.Ct. 2173 at 2180, 2181 (1968):

As the Court said last Term, "there is no simple test for ascertaining whether an institution is so closely related to governmental activity as to become a tax-immune instrumentality," *Department of Employment v. United States*, 385 U.S. 355, 358-359, 87 S.Ct. 464, 467 17 L.Ed.2d 414 (1966) (holding Red Cross immune). Various formulations of the controlling test have been used to determine whether institutions or individuals are immune: whether they "have been so incorporated into the government structure as to become instrumentalities of the United States and thus enjoy governmental immunity," *United States v. Boyd*, 378 U.S. 39, 48, 84 S.Ct. 1518, 1524, 12 L.Ed.2d 713 (1964); whether they "are arms of the government deemed by it essential for the performance of governmental functions," and "are integral parts of [a government department and] . . . share in fulfilling the duties entrusted to it," *Standard Oil Co. of California v. Johnson*, 316 U.S. 481, 485, 62 S.Ct. 1168, 1170, 86 L.Ed. 1611 (1942) (Army post-exchanges immune); whether they have been so "assimilated by the government as to become one of its constituent parts," *United States v. Township of Muskegon*, 355 U.S. 484, 486, 78 S.Ct. 483, 485, 2L.Ed.2d 436 (1958); and whether the institution is regarded "virtually as an arm of the Government," *Department of Employment v. United States*, supra, 385 U.S. at 359-360, 87 S.Ct. at 467.

Under those general rubrics, the Court has looked to various specific factors and characteristics to determine the status of the specific institution: whether it is organized for private profit, and whether the government has retained such control over it so that "it could properly be called a 'servant' of the United States in agency terms" *United States v. Township of Muskegon*, supra, 355 U.S., at 486, 78 S.Ct., at 485; whether it was organized to effectuate a specific governmental program, *Federal Land Bank of St. Paul v. Bismark Lumber Co.*, 314 U.S. 95, 102, 62 S.Ct. 1, 5, 86 L.Ed. 65 (1941); whether its ownership, substantially or totally, lies in the government, *Clallam County, Wash. v. United States*, 263 U.S. 341, 343, 44 S.Ct. 21, 68 L.Ed. 328 (1923); *Railroad Co. v. Peniston*, (18 Wall) at 32, 21 L.Ed. 787 whether government officials handle and control its operations, *Standard Oil Co. v. Johnson*, supra; whether its officers or any significant portion of them are appointed by the government, *Department of Employment v. United States*, supra; compare *Railroad Co. v. Peniston*, supra; whether the government gives it significant financial aid, whether it is charged by law with carrying out some of the government's international commitments, and whether it performs "functions indispensable to the

stitution to be immune from taxation as an instrumentality of the federal government, it must either be tightly controlled by the federal government or depend upon the federal government for its ability to exist. Neither of these criteria fits state banks. They were not created by Congressional action, they are privately owned and controlled, they are regulated by state authorities, and they are not required to be members of the Federal Reserve System.<sup>13</sup> A large per-

workings" of a governmental unit, *Department of Employment v. United States*, *supra*, 385 U.S. at 359, 87 S.Ct. at 467.

See also: Thomas R. Powell, *The Waning of Intergovernmental Tax Immunity*, 58 HARV. L. REV. 633 (1944); Powell, *The Remnant of Intergovernmental Tax Immunities*, 58 HARV. L. REV. 757 (1945). Apparently, the Supreme Court is moving toward the position that determination of whether a federal instrumentality is tax immune should be left to the Congress. An organization which is largely private, but has some governmental ties may be unable to gain tax immunity unless an Act of Congress grants that immunity. It seems likely that the Court will be hesitant in the future to find an "implied immunity." See the *First Agricultural* dissent, 392 U.S. 339, at 348; 88 S.Ct. 2173, at 2178 (1968).

An over-zealous headnote author wrote in headnote 4. of *Westfall v. United States*, 47 S.Ct. 629 (1927) that:

"Congress may employ state corporations with their consent as instrumentalities of the United States. . ."

There is no support for this statement in the opinion which considers state banks more nearly voluntary participants in a government program (The Federal Reserve System) than instrumentalities.

<sup>13</sup> See: *Amicus Curiae* Brief submitted by James F. Bell and Brian C. Elmer, Attorneys for National Association of Supervisors of State Bank, in the case of: *First Agricultural National Bank of Berkshire County v. State Tax Commission*. (1967), p. 20 where a summary of the characteristics of state and national banks is given.

Aside from the licensing and supervisory role of the federal government, national banks are virtually identical to state-chartered banks. The following table compares the two types of institutions:

	<i>State Banks</i>	<i>National Banks</i>
Ownership	Private stockholders	Private stockholders
Capital Source	All private	All private
Control	All private	All private
Insured by	97% by FDIC	100% by FDIC
Primary regulatory agency	State authorities	Comptroller of the Currency
Authority to issue legal tender	No	No
Authorized to act as depositories of federal funds	Yes	Yes
Branch authority	Determined by state law	Determined by state law
Membership in FRS	Permitted	Required

centage of state banks are not members of the Federal Reserve System.<sup>14</sup>

Therefore, state banks are not federal instrumentalities.

### *Commerce Clause*

Though Congress cannot restrict state taxation of state banks simply by classifying them as government instrumentalities, it can restrict such taxation by use of the power granted Congress under the Commerce Clause<sup>15</sup> in conjunction with Article 1, § 8, Clause 18,<sup>16</sup> and the Supremacy Clause<sup>17</sup> of the United States Constitution.

It is clearly established that where Congress determines that a state or local tax unduly burdens the free flow of interstate commerce, it may restrict or prohibit the state or local taxation.<sup>18</sup> A leading case which declares the principal of Congressional control over state and local taxation of interstate commerce is *International Shoe Company v. Cocreham*.<sup>19</sup> There the highest court of Louisiana upheld

<sup>14</sup> ANNUAL REPORT OF THE FDIC, 1968 (1969), pp. 166, 167.

<sup>15</sup> U.S.C.A. Constitution, Art. 1, § 8, cl. 3.

<sup>16</sup> U.S.C.A. Constitution, Art. 1, § 8, cl. 18: ("The Congress shall have Power) to make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.")

<sup>17</sup> U.S.C.A. Constitution, Art. 6, Cl. 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any thing in the Constitution or Laws of any State to the contrary notwithstanding."

<sup>18</sup> See: *Northwest Airlines, Inc. v. State of Minnesota*, 322 U.S. 292, 303, 304; 64 S. Ct. 950 at 956 (1944) *in dictum* where it was stated by the Court that: "Congress has not extended its protection and control to the field of (state) taxation, although I take it no one denies that constitutionally it may do so. It may exact a single uniform federal tax on the property or the business to the exclusion of taxation by the states. It may subject the vehicles or other incidents to any type of state and local taxation, or it may declare them tax-free altogether." See also: footnote 19 and accompanying text.

<sup>19</sup> 164 So.2d 314, 246 La. 244 (1964), *cert. denied*, *Moutin v. International Shoe Co.*, 379 U.S. 902, 85 S.Ct. 193 (1964). See also: *Ciba v. State Tax Commission*, 382 S.W.2d 645 and *Smith, Klein & French Laboratories v. State Tax Commission*, 403 P.2d 375 (Oregon, 1965). Both *International Shoe* and *Smith, Kline & French* are reproduced in the appendix to this memorandum.

PL 86-272, which barred states from imposing a net income tax on orders obtained in-state by salesmen from out-of-state firms which processed and filled the orders out of the state.<sup>20</sup> Before Congressional passage of PL 86-272, the United States Supreme Court had declared such state taxation constitutional—finding no violation of the Commerce Clause and sufficient connection or “nexus” between services rendered by the states to the companies taxed and the tax to satisfy the Due Process Clause requirement.<sup>21</sup>

The Louisiana Supreme Court held that on the basis of much United States Supreme Court precedent, Congress has the power to restrict state taxation of interstate commerce, even though such state taxation had formerly been held to be constitutional.<sup>22</sup>

The Louisiana Supreme Court also held that the failure of Congress to act earlier to curtail state taxation of net income from personally solicited interstate sales did not estop Congress from later restricting such taxation.<sup>23</sup>

*International Shoe* also held that whenever there is a colorable claim that Congress could stimulate or protect interstate commerce by restriction of state taxation, then the courts will respect the Congressional action and not quarrel with whether it would truly protect or stimulate interstate commerce.<sup>24</sup>

<sup>20</sup> 164 So.2d 314, 316, 317.

<sup>21</sup> *Id.* at 316.

<sup>22</sup> *Id.* at 320:

“The foregoing authorities of the Supreme Court, and there are many others, conclusively establish that, until Congress acts in the field of interstate commerce, the courts, perforce, are required to determine whether a particular state tax unconstitutionally burdens or affects the free flow of commerce. But, when Congress speaks, the right of the judiciary to determine whether the burden is undue or not is foreclosed.”

<sup>23</sup> *Id.* at 321: “(O)nce the power (to regulate interstate commerce) is given it continues as a legislative power and may be exerted at any time. Failure to act does not curtail or limit the power. Nor does the exertion of judicial power by negative action, which as we have shown, the Court was able to exercise only because Congress had not acted, create an estoppel against subsequent contrary legislative action.”

<sup>24</sup> *Id.* at 322. See also: *Katzenbach v. McClung*, 379 U.S. 294, 303, 304;

Thus, under *International Shoe* and dicta in the Supreme Court holding in *Northwest Airlines v. Minnesota*,<sup>25</sup> Congress may regulate state taxation of an institution if there is a showing that (1) the institution is engaged in interstate commerce and (2) there is a colorable claim that the Congressional restriction protects or stimulates interstate trade.

Recent Supreme Court interpretation of what constitutes interstate commerce has been so broad that virtually every business activity falls within the scope of the Commerce Clause. This is perhaps best demonstrated by *Katzenbach v. McClung*,<sup>26</sup> a test case for Title II of the Civil Rights Act of 1964. There the Supreme Court held that the Commerce Clause gave Congress the power to require service to Negroes by a restaurant which served no out-of-state customers. The Court held that Congress had sufficient evidence to give it a colorable claim that refusal of service to Negroes imposed a burden on the flow of food and upon the movement of products generally.<sup>27</sup>

Moreover, the Court held that the Congress could make a general regulation that *all* restaurants must serve Negroes, even though some restaurants, perhaps, did not purchase out-of-state food or serve out-of-state customers.<sup>28</sup> In other words, all restaurants are bound by the Civil Rights Law even though some individual restaurants might be shown not to directly affect interstate commerce by their exclusion of Negroes.

Closer to the fact situation of Congressional regulation

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85 S. Ct. 377, 383 (1964): "Of course, the mere fact that Congress has said when particular activity shall be deemed to affect commerce does not preclude further examination by this Court. But where we find that the legislators, in light of the facts and testimony before them, have a rational basis for finding a chosen regulatory scheme necessary to the protection of commerce, our investigation is at an end."

<sup>25</sup> 322 U.S. 292, 303, 304. See footnote 18, *supra*.

<sup>26</sup> 379 U.S. 294, 85 S. Ct. 377 (1964). See also: the companion case of *Heart of Atlanta Motel v. United States*, 379 U.S. 241, 85 S.Ct. 348 (1964).

<sup>27</sup> 379 U.S. 294, 303, 304, 85 S. Ct. 377, 383, 384 (1964).

<sup>28</sup> *Id.*

of state taxation of banks is the case of *United States v. South-Eastern Underwriters Ass'n.*<sup>29</sup> There the Court upheld the power of Congress to regulate fire insurance company transactions. The Court held that interstate commerce takes place if

“The decisions which the company makes at its home office—the risks it insures, the premiums it charges, the investments it makes, the losses it pays—concern not just the people of the state where the home office happens to be located. They concern people living far beyond the boundaries of that state.”<sup>30</sup>

Later, the Court said:

“Not only, then, may transactions be commerce though non-commercial; they may be commerce though illegal and sporadic, and though they do not utilize common carriers or concern the flow of anything more tangible than electrons and information. These activities having already been held to constitute interstate commerce, and persons engaged in them therefore having been held subject to federal regulation, it would indeed be difficult now to hold that no activities of any insurance company can ever constitute interstate commerce so as to make it subject to such regulation;—activities which, as part of the conduct of a legitimate and useful commercial enterprise, may embrace integrated operations in many states and *involve the transmission of great quantities of money, documents, and communications across dozens of state lines.*”<sup>31</sup> (Emphasis added.)

Banking fits well into the Supreme Court's view of what constitutes interstate commerce. Banking operations “involve the transmission of great quantities of money, documents, and communications across state lines.”<sup>32</sup> Banking operations directly affect the operations of interstate business. The flow of credit to business is part of the “chain of events”<sup>33</sup> which has a major impact on interstate business by

<sup>29</sup> 322 U.S. 533, 64 S. Ct. 1162 (1944).

<sup>30</sup> 322 U.S. 533, 541, 542; 64 S. Ct. 1162, 1167 (1944).

<sup>31</sup> 322 U.S. 533, 549, 550; 64 S. Ct. 1162, 1172 (1944).

<sup>32</sup> *Id.*

<sup>33</sup> In *United States v. South-Eastern Underwriters*, 322 U.S. 533, 546, 547;

affecting new building business formations; and the general ability of business to borrow.

The Federal Reserve report on *State and Local Taxation of Banks*, gives the Congress a colorable claim that federal restriction of state taxation of state banks is necessary to protect interstate commerce. The study found that:

"If [Section 4(a) of Public Law 91-156] is allowed to go into effect without revision, the changed tax status of banks might open the way for State and local tax measures that could impair the ability of the banking system and possibly the entire structure of financial intermediaries to contribute to the efficient allocation of the Nation's credit resources."<sup>34</sup>

Similarly, it has been argued by commentators that for reasons of efficiency, economy, and visibility, the Congress would protect and benefit the flow of interstate commerce by unifying the control of all banks, probably under the Comptroller of the Currency.

It appears that state banks are sufficiently engaged in interstate commerce to fall within the authority of Congress to regulate interstate commerce.<sup>35</sup>

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64 S. Ct. 1162, 1170 the Court said: "We may grant that a contract of insurance, considered as a thing apart from negotiation and execution, does not itself constitute interstate commerce. (Cases omitted.) But it does not follow from this that the Court is powerless to examine the entire transaction, of which that contract is but a part, in order to determine whether there may be a *chain of events which becomes interstate commerce.*" (Emphasis added.)

<sup>34</sup> STATE AND LOCAL TAXATION OF BANKS, PREPARED BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FOR THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, UNITED STATES SENATE, 92d Congress, 1st Session, at 1 (May, 1971).

<sup>35</sup> See: Robertson: *Federal Regulation of Banking: A Plea for Unification*, 31 LAW & CONTEMPORARY PROBS. 673 (1966); Wille, *State Banking: A Study in Dual Regulation*, 31 LAW & CONTEMPORARY PROBS. 733 (1966); E. Redford, *Dual Banking: A Case Study in Federalism*, 31 LAW & CONTEMPORARY PROBS. 749 (1966). In the latter article Redford expounded on some of the reasons unification would benefit interstate commerce:

"Shortly after the Chase decided to renounce its 166-year-old state charter, an article discussing the implications of the conversion appeared in the NEW YORK TIMES. Frost, *Chase Bank Move Has Broad Impact*, N. Y. TIMES, July 18, 1965, 3, at 1, col. 8. In an interview with the TIMES reporter, one of Chase's senior officials summed up the chief advantages of being a national bank in one word—"flexibility." More specifically, the officer was reported as

The trend toward federal control of state banks is already clearly established. There has been limited federal regulation of state banks for many years. In the case of the Federal Reserve and the FDIC, the benefits offered to state banks lend to the acceptance of national jurisdiction. In some other cases national policy is compulsory. The bank-closing order of the President in 1933 applied to all banks. The Securities Exchange Act of 1934 gave the Federal Reserve Board authority to prescribe regulations on the amount of credit for stock purchases that are applicable to

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citing the following as among its reasons for the change: (1) "some states, such as Pennsylvania and Illinois, summarily prohibit state chartered banks of other states from doing business in their territory"; (2) "certificates of deposit of national banks . . . (are) not subject to 'blue sky laws'"; and (3) "state banks still can't sell (travelers checks) in Illinois and Pennsylvania."

The President of the Provident National Bank was reported as pointing out that "stockholders of state-chartered banks living in states other than those in which the bank operates paid taxes on dividends, which was not the case with stockholders of national banks." And both he and the president of Mercantile Trust added that "the swiftness with which Mr. Saxon acted on branching applications was a factor." In this connection, the reporter suggested that "in New York, as in some other states, consideration must also be given to the effect on state chartered mutual savings banks, an obstacle Mr. Saxon does not face." Other factors which the TIMES discussion mentioned as favoring national bank status were that: (1) "state-chartered banks operating in other states are taxed as 'out-of-state corporations,' while national banks are immune from such taxes"; (2) "the New York lawmakers have . . . failed to give its state-chartered banks the right to go into direct equipment leasing and the factoring business"; and (3) "national banks have been given broader powers in the underwriting of certain tax-exempt issues."

Several striking features of the new intersystem competition are evident. First, the competitive handicaps cited by the Chase were not strictly those attributable to New York law, which at the time was relatively up-to-date if not in advance of the field in modernization; the defensive laws of other states, preventing or inhibiting various kinds of interstate business except under national charter, were perhaps the primary factor cited. In addition, the motivating factors in recent years and apt also to include regulatory differences originating at the national level in conflicts between the Comptroller and the other two banking agencies in Washington. The result of these circumstances is that no state legislature can rectify the situation acting alone, either because the problem results from the laws of other states or because it reflects the multiplicity of regulatory systems at the national level. Thus, the banking business and bank regulation have apparently become so complex and pervasive that state systems no longer fully control their own destiny through the power to legislate inducements. We will have occasion below to see how the states are being encircled and regulatory power drained to Washington."

all banks.<sup>36</sup> Although states are allowed to adopt stricter standards on bank holding companies, the Bank Holding Company Act of 1956 establishes unified national supervision of all bank holding companies and national approval of holding company acquisitions.<sup>37</sup> The bank merger legislation of 1960 and 1966 applies to all insured banks and places responsibility for administration in the three supervisory agencies,<sup>38</sup> and, in addition, all banks are subject to the Sherman Act and the Clayton Act.<sup>39</sup> In every instance in which these federal regulations of state banks have been challenged the regulations have been sustained by the courts as constitutional.

In *Doherty v. United States*<sup>40</sup> the provision in the FDIC Act allowing state bank membership was upheld as a valid use of Congressional Power under the Commerce Clause and as valid use of Congressional authority to regulate the currency.<sup>41</sup> In *Hiatt v. United States*<sup>42</sup> a Seventh Circuit Court held that the United States Congress has the power to open membership in the Federal Reserve System to state banks. The circuit court stated that:

“The contention that the provisions of the Federal Reserve Banking Act, c. 6 (38 Stat. 251) authorizing any bank or trust company of a state to become a member bank of the Federal Reserve System are beyond the constitutional powers of Congress seems hardly open for discussion. In *First Nat. Bank v. Fellows*, 244 U.S. 416, 420, 37 S. Ct. 734, 735 (61 L. Ed. 1233, L.R.A. 1913C, 283, Ann. Cas. 1918D, 1169), the Supreme Court, inter-

<sup>36</sup> 15 U.S.C. § 78(g) (1964).

<sup>37</sup> 12 U.S.C.A. §§ 1841-49 (Supp. 1966).

<sup>38</sup> 12 U.S.C.A. § 1828(c) (Supp. 1966).

<sup>39</sup> 15 U.S.C.A. §§ 1-7 (1964); 15 U.S.C. §§ 12-27 (1964).

<sup>40</sup> 94 F.2d 495 (8th Cir., 1938), *cert. denied*, 303 U.S. 658, 58 S.Ct. 763 (1938).

<sup>41</sup> At 92 F.2d 495, 497 the 8th Circuit Court stated that: “(A)s Congress had the right to create ‘the (FDIC) and make it a depository of public moneys of the United States and a financial agent of the government, it must be conceded the power to enact such regulatory legislation as it deemed necessary to protect and make effective this government agency.”

<sup>42</sup> 4 F.2d 374, 376, 377 (7th Cir., 1925), *cert. denied*, 268 U.S. 704, 45 S.Ct. 638 (1925).

preting *Osborn v. Bank*, 9 Wheat. 738, 6 L. Ed. 204, and *McCulloch v. Maryland*, 4 Wheat. 316, 4 L. Ed. 579, has said:

'The ruling in effect was that, although a particular character of business might not be, when isolatedly considered, within the implied power of Congress, if such business was appropriate or relevant to the banking business, the implied power was to be tested by the right to create the bank and the authority to attach to it that which was relevant in the judgment of Congress to make the business of the bank successful.'

"When the Federal Reserve System was created, the banking business of the states and of the nation was done by national banks incorporated under federal law, state banks incorporated under state laws, and unincorporated private banks. While there had necessarily grown up business relations between the various banks, regardless of their origin, they were largely voluntary. Without going fully into the causes which produced the Federal Reserve System or the purposes of its creation, further than those expressed in the title, viz. 'To provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes,' it is sufficient to say that it had long been recognized that for the purpose of carrying on undisturbed the necessary business and financial operations of the government some system should be devised whereby the banking operations of the country could be controlled and sudden and violent crises in financial affairs prevented. If, in the wisdom of Congress, it seemed that the inclusion of state banks and trust companies would contribute to such and other legitimate purposes of the Federal Reserve System, the right to so include them would seem not now open to question. The government may make use of concerns incorporated under state charters."<sup>43</sup>

Also, in the related case of *United States v. South-Eastern Underwriters Assn.*<sup>44</sup> the Supreme Court upheld the right of Congress to regulate fire insurance companies which had

<sup>43</sup> 4 F.2d 374, 376, 377.

<sup>44</sup> 322 U.S. 533, 64 S.Ct. 1162 (1944).

previously been supervised by state, rather than federal, agencies.

*Secondary Lines of Authority for Congressional Regulation of State Banks*

Many cases specifically or by implication construe Congressional authority to borrow money<sup>45</sup> and to regulate the currency<sup>46</sup> as giving Congress very broad authority over the banking industry.<sup>47</sup> The Federal Reserve Report on PL 91-156 concludes that federal regulations of state taxation of national *and* state banks are necessary to protect the efficiency of the nation's credit resources.<sup>48</sup> This statement suggests that Congress can claim that it must act under its power to borrow money and to regulate the currency in order to protect the nation's credit resources from the potential harm of uncontrolled state taxation of state banks.<sup>49</sup>

**Conclusion**

For the reasons given above, I conclude that Congress has the authority under the United States Constitution to regulate state taxation of state banks. This authority stems primarily from the Commerce Clause. Congressional authority to regulate the currency and borrow money is a possible secondary source of Congressional authority.

<sup>45</sup> U.S.C.A. Constitution, Art. 1, § 8, cl. 2.

<sup>46</sup> U.S.C.A. Constitution, Art. 1, § 8, cl. 5.

<sup>47</sup> *Hiatt v. United States*, 7 F.2d 234, 236, 327 (7th Cir. 1925). Cert. denied, 268 U.S. 704, 45 S.Ct. 638 (1925); *McCulloch v. Maryland*, 4 Wheat. 316, 7 L.Ed. 579 (1819). *Osborn v. Bank*, 9 Wheat. 738, 6 L.Ed. 204 (1824); *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 41 S.Ct. 243 (1920); *First National Bank v. Fellows*, 247 U.S. 416, 37 S.Ct. 734 (1917); *Norman v. Baltimore & Ohio R.R. Co.*, 294 U.S. 240, 55 S.Ct. 407 (1935); *Westfall v. United States*, 227 U.S. 256, 47 S.Ct. 629, 630 (1926).

<sup>48</sup> FED. RES. STUDY at 1.

<sup>49</sup> Whether 91-156 without the amendments recommended by the Federal Reserve Board would actually act to the detriment of the banking systems' ability to contribute to the efficient allocation of the nation's credit resources is an economic question beyond the scope of this article. However, as noted above at *note 27 and accompanying text*, the Supreme Court generally accepts legislative discretion on economic claims as long as a colorable claim can be made that Congressional action was needed to protect an area of authority given to Congress by the Constitution.

The CHAIRMAN. Thank you very much. We surely appreciate your appearance.

Mr. Tom B. Scott, Jr., chairman of the legislative committee, United States Savings and Loan League. Come around, Mr. Scott. We are very glad to have you, sir.

**STATEMENT OF TOM B. SCOTT, JR., CHAIRMAN, LEGISLATIVE COMMITTEE, UNITED STATES SAVINGS AND LOAN LEAGUE, ACCOMPANIED BY STEPHEN SLIPHER, STAFF VICE PRESIDENT AND LEGISLATIVE DIRECTOR**

Mr. SCOTT. Thank you, Mr. Chairman.

The CHAIRMAN. Who is this on crutches?

Mr. SLIPHER. Nothing to do with our testimony, Mr. Chairman. A little golfcart accident.

The CHAIRMAN. I always thought you played golf to get exercise.

Mr. SLIPHER. I did until May 6.

The CHAIRMAN. We are glad to have you here, Mr. Slipher.

Mr. SCOTT. My name is Tom B. Scott, Jr., of Jackson, Miss., and I appear here as chairman of the legislative committee of the United States Savings and Loan League.

With me is Stephen Slipher, staff vice president and legislative director of our league.

**FULL DEPOSIT INSURANCE OF PUBLIC FUNDS**

We appreciate this opportunity to express our views on S. 3652 primarily with respect to Senator Proxmire's Amendment 1364 providing full deposit insurance for public funds. The Senator estimates that there are over \$30 billion of time deposits of State, county and city units with 98 percent of it in commercial banks and only about 2 percent of it in savings and loan associations.

This is because custodians of public funds—either by law, regulation, or custom—limit their deposits in financial institutions to the insured ceiling of \$20,000 or require the pledging of Government bonds as collateral. Savings and loan associations are not authorized to pledge bonds as collateral and hence hold only token amounts of Government deposits.

By providing 100 percent insurance of public funds, public officials would be provided with greater convenience, wider choice, and complete safety in choosing depositories. It would not be necessary for them to go through the cumbersome process of dividing large sums into \$20,000 units in various institutions or obtaining the necessary agreement to pledge Government bonds.

As a practical matter, in many cities and towns across the country, the largest financial institution—the savings and loan association—is effectively barred from competing for public funds. An increase in investment in savings and loan associations would channel substantial additional funds into housing since associations invest a far greater portion of their assets in residential loans than any other financial institution.

In 1970, legislative consideration was given to authorization of savings and loan associations to place collateral against public funds, but this failed final enactment because of a belief that this authority could be provided by regulation. However, the Federal Home Loan

Bank Board subsequently determined that the collateralization method could not be legally and practically used by savings associations.

The establishment of 100 percent insurance of public funds would not provide any individual with a special insurance advantage. These public funds belong to hundreds or thousands of individuals, none of whom have an interest even approaching the \$20,000 insurance ceiling. A million dollar city fund may represent the funds of 50,000 citizens of the community, each of whom would have a pro rata share of only, say, \$20.

Experts on the FSLIC and FDIC agree that full insurance of public funds would not adversely affect the soundness of the insuring agencies.

This question of 100 percent insurance is of more than academic interest. While, of course, financial institutions generally have an outstanding record of safety, there have been a few instances of institutions being in default and substantial losses suffered by public units. A school board in Massachusetts is currently facing a potential loss of nearly \$800,000 because of a bank failure.

The chairman mentioned the Commonwealth Bank in Detroit and the near miss of a loss of \$150 million. These unfortunate occurrences would not be possible if this legislation were enacted.

Adequate provision is made so that the regulatory agents could limit the amount of public funds accepted by an individual insured institution so that no institution would hold large deposits which could create losses or a withdrawal problem.

We are familiar with the arguments in opposition which are advanced primarily by the commercial bankers who hold almost all of the billions of dollars in public funds and naturally object to the diversion of some of it to thrift institutions. However, the reasons they generally put forth simply do not hold water. And we refer you to our addendum A comments on these arguments.

#### FREE CASHING OF FEDERAL CHECKS

The second portion of Amendment 1364 deals with the mandatory free cashing of Federal checks by insured banks and savings and loan associations. As we have announced previously, the league recognizes the underlying philosophy that financial institutions should accommodate citizens who need to cash Government checks and do not have established banking connections.

As laudable as the objective of the bill may be, we are increasingly aware of some practical and serious problems involved. In the case of small financial institutions located near Government offices or in neighborhoods with concentrations of social security checks, there simply would not be enough cash or personnel to handle the potential requirements. Even larger institutions which have experimented with free check cashing have experienced long lines at teller windows which impeded service to regular customers.

The problem is compounded by long delays between the cashing of the Federal check to the "wrong" person and the eventual notification by the Treasury that the bona fide recipient of the check demands payment.

Furthermore, no matter how careful the financial institution has been, the Treasury takes no responsibility for reimbursing the institution.

Also, the Government has made no effective effort to develop a uniform foolproof identification card. The volume of misplaced Federal checks has reached such proportions that the Congress recently enacted H.R. 8708 to encourage greater direct deposit of Federal payments to avoid risking them in the mail.

As drafted, this legislation allows a 90-day period before the effective date and designates the Secretary of the Treasury to implement the law. We think more time and flexibility may be needed. Addendum B describes some of the questions and problems which are involved.

I would like to point out another aspect of this legislation to the committee. The rationale for requiring Federal check cashing for financial institutions appears to be that financial institutions:

1. Enjoy Federal insurance;
2. Have a valuable and exclusive franchise of conducting checking account services; and
3. Receive interest-free "tax and loan" deposits of Federal funds.

In reality, however, only one of these three is applicable to savings and loan associations—Federal insurance. And, even in this case, the savings and loan business pays the full cost of the insurance, there being no charge to the saver and no Federal fund use.

As to the valuable franchise to provide checking account services, this remains the exclusive prerogative of the commercial banking business. There has been discussion of authorizing savings and loan associations to have checking accounts, but it has never been enacted. Are we being unreasonable when we question whether we should be subjected to the responsibilities of free check cashing services unless and until we are also authorized to conduct a checking account business?

Similarly, we receive none of the \$9 billion of interest-free tax and loan accounts. All of these funds are deposited in commercial banks who do not pay interest on them because of the assumption that they are providing the Government and the public compensating free service. However, the merit of these issues is for this committee to decide.

In any case, given appropriate time and study, we feel that a reasonable program of check cashing could be developed. We would be happy to cooperate with this committee, the Treasury, and the Federal financial agencies toward this end.

Thank you, Mr. Chairman, for affording us this opportunity.

The CHAIRMAN. Thank you very much, Mr. Scott.

With reference to the Government checks, cashing of Government checks, are you familiar with what is generally called the Philadelphia plan?

Mr. SCOTT. Yes, sir, a reading knowledge of it.

The CHAIRMAN. Do you not think that could be put to good use everywhere?

Mr. SCOTT. It seems to be a very sound plan.

The CHAIRMAN. And it seems all organizations would gladly cooperate.

Mr. SCOTT. I think you could depend on savings and loan associations to cooperate to a similar plan.

The CHAIRMAN. Now, with reference to the 100-percent insurance of public funds, did you hear Mr. Wille's testimony?

Mr. SCOTT. Yes, I did.

The CHAIRMAN. What would you think of the amendments that he suggested to the bills?

Mr. SCOTT. That related to rate control?

The CHAIRMAN. Well, I believe the second amendment on the second part of his amendment would provide for—

Mr. SCOTT. Equalization.

The CHAIRMAN (continuing). Equalization of rates.

Mr. SCOTT. Well, my answer to that is this matter of rate control and equalization will be before the Congress in June of 1973, and there is ample opportunity to deal with the problem. I do not see any relation between 100-percent insurance and rate control, but as I say, the matter will be before the Congress in 1973.

The CHAIRMAN. Of course, I have always supported a differential from the beginning, and it seems to me that this really grew out of the action of the Federal Reserve Board in the latter part of 1965. I remember the action which I think was responsible for the severe money crunch that we had in 1966. And as I recall, it was somewhat after that that we provided for the differential of rates in order to try to stabilize deposits. It seems to have worked very well.

I have felt it worked very well, but as you say, it is something for the Congress to consider anew in June of next year.

I wonder if I might ask you this question: It is true it is coming up for consideration in June, but suppose the Proxmire proposal should be amended by adding that, would you then support the Proxmire amendment as you do now?

Mr. SLIPHER. Senator, let me mention something that is in Mr. Wille's testimony. He pointed out that currently on the over \$100,000 amounts on the short-term maturities, the banks now have no ceiling. That particular area is free of rate control. On the other maturities, the same rates apply for banks and savings and loans.

So as a practical matter on the large deposits—most of these public funds are over \$100,000—there is rate equality right now. I think our view would be that it is there for the large accounts, and we would not want to tamper with the principle by having an amendment in here that would reach into the whole area of rate control. They have practical equality now on big deposits and I think the savings and loan business feels as you do that the rate differential principle is very important when you get down to the passbook amounts and with that amendment like that, I doubt if we would support it.

I think that losing that important differential that is so needed to get money into housing, is too much of a price to pay.

The CHAIRMAN. I was wondering myself if your attitude would not be that. As I said, I have always supported the rate differential. As I said, it has worked very well and has given us a degree of stabilization in financing home mortgages that certainly we have not always had. Would you not agree with that?

Mr. SLIPHER. We are not talking about a large amount of money. I would not imagine savings and loans would get up to even 5 percent of deposits of this kind in the near future. And to tamper with the whole rate control structure over this, I think would be a mistake.

The CHAIRMAN. Well, thank you very much, both of you gentlemen. I appreciate it.

(The full prepared statement of the U.S. Savings and Loan League and addendums follow:)

STATEMENT OF

UNITED STATES SAVINGS AND LOAN LEAGUE \*

BY

TOM B. SCOTT, JR.

CHAIRMAN, LEGISLATIVE COMMITTEE

BEFORE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

AUGUST 2, 1972

"Full Deposit Insurance of Public Funds"  
and related financial legislation

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\* The United States Savings and Loan League has a membership of 4,800 savings and loan associations, representing over 95 percent of the assets of the savings and loan business. League membership includes all types of associations -- Federal and state-chartered, insured and uninsured, stock and mutual. The principal officers are: John P. Farry, President, Albert Lea, Minnesota; Richard G. Gilbert, Vice President, Canton, Ohio; Tom B. Scott, Jr., Legislative Chairman, Jackson, Mississippi; Norman Strunk, Executive Vice President, Chicago Illinois; and Stephen Slipher, Legislative Director, Washington, D.C. League headquarters are at 111 East Wacker Drive, Chicago, Illinois (60601); and the Washington Office is located at 425 13th Street, N.W., Washington, D.C.; Telephone 638-6334.

STATEMENT OF TOM B. SCOTT, JR., LEGISLATIVE CHAIRMAN, U.S. SAVINGS & LOAN LEAGUE  
BEFORE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS - AUGUST 2, 1972

My name is Tom B. Scott, Jr., of Jackson, Mississippi, and I appear here as Chairman of the Legislative Committee of the United States Savings and Loan League.

We appreciate this opportunity to express our views on S. 3652, primarily with respect to Senator Proxmire's Amendment 1364 providing full deposit insurance for public funds. The Senator estimates that there are over \$30 billion dollars of time deposits of State, county, and city units with 98 percent of it in commercial banks and only about 2 percent of it in savings and loan associations. This is because custodians of public funds -- either by law, regulation, or custom -- limit their deposits in financial institutions to the insured ceiling of \$20,000 or require the pledging of Government bonds as collateral. Savings and loan associations are not authorized to pledge bonds as collateral and hence hold only token amounts of Government deposits.

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of dollars in public funds and naturally object to the diversion of some of it to thrift institutions. However, the reasons they generally put forth simply don't hold water. Addendum A comments on these arguments.

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In any case, given appropriate time and study, we feel that a reasonable program of check cashing could be developed. We would be happy to cooperate with this Committee, the Treasury, and the Federal financial agencies toward this end.

COMMENTS ON ARGUMENTS WHICH HAVE BEEN RAISED AGAINST FULL DEPOSIT INSURANCE  
OF PUBLIC FUNDS

Proposals for 100% deposit insurance for funds of state, county, and political units (public funds) have been discussed for several years. The principal arguments in opposition to the proposals are listed below together with the response of the U.S. Savings and Loan League:

# ARGUMENT: Full insurance of public funds will inevitably lead to 100% insurance of all deposits.

U.S. LEAGUE RESPONSE: This argument assumes that Congress is not capable of dealing with future legislative proposals on the merits as they exist at that time. Presently, there is no proposal pending for 100% insurance of all deposits and, should it be made, the Congress would hold full hearings and opponents of it could state their arguments at that time. This general argument that one proposal leads to another has been raised unsuccessfully by banking groups against every increase in deposit insurance over the past 20 years.

# ARGUMENT: Full insurance of deposits would eliminate the need to collateralize public funds, thus dangerously weakening the market for Federal and municipal bonds.

U.S. LEAGUE RESPONSE: Commercial banks hold municipal and Federal bonds far in excess of any existing requirements for collateralization. Members of the Federal Reserve have about \$170 billion of municipal and Federal obligations versus about \$30 billion of public deposits. Obviously, the Government bond holdings are not appreciably affected by collateral requirements. Banks hold municipal bonds for investment purposes and especially to gain tax exempt income. Their large holdings in municipal bonds are one factor in the recent statement of former Secretary of Treasury Joseph Barr to the effect that the nation's largest commercial banks are moving toward a zero Federal income tax. In any event, there are much more direct and efficient ways of requiring financial institutions to buy and hold Government obligations than reliance on the side effects of public deposit collateralization.

# ARGUMENT: Savings and loan associations are not equipped to handle public deposits.

U.S. LEAGUE RESPONSE: Savings and loan associations have already had successful experience in handling substantial deposits of individuals or corporations. Many savings and loans are as large, or larger, than the commercial banks in the communities. Savings and loan associations are adequately supervised by the Federal Home Loan Bank Board. The proposed legislation specifically directs the Federal agencies to establish limits on the deposits which could be received by an individual institution. Thus, public funds would not create any withdrawal or liquidity problems.

SOME PROBLEMS AND QUESTIONS INVOLVED IN THE CASHING OF FEDERAL CHECKS BY  
FINANCIAL INSTITUTIONS

- I. Volume and Distribution of Federal Checks
- (A) Total number of Federal payroll and benefit checks.
  - (B) Percentage of checks deposited automatically or handled by recipient's regular bank.
  - (C) Volume of checks to be cashed outside of regular channels (and thus eligible under "free cashing" provision).
  - (D) Check distribution by time of month.
- II. Problem of Concentration of Checks on Small Institutions
- (A) Identification of areas where the number of "free cashing" checks is large relative to available banking facilities.
  - (B) Feasibility of Federal agencies prorating checks (such as alphabetically) to financial institutions in area.
  - (C) Feasibility of "pooling arrangement" to cash checks on Government premises.
- III. Fraud and Identification Problems
- (A) Current report of extent of false identification and fraud losses.
  - (B) Investigation of time delay in discovering and handling false check cashing.
  - (C) Feasibility of uniform, modern identification cards with photograph and identification data.
  - (D) Consideration of improved criminal prosecution as a deterrent to check abusers.
- IV. Methods of Distributing Costs in Check Cashing
- (A) Determination of true cost (out-of-pocket expense) of cashing Federal checks.
  - (B) Attitude of check recipients to a nominal charge of 10¢ to 25¢.
  - (C) Feasibility of financial institutions sharing the cost through the FSLIC and FDIC or special assessments.
  - (D) Feasibility of absorption of cost by Treasury.
  - (E) Feasibility of more practical and effective private insurance to cover check losses.

The CHAIRMAN. Mr. Raleigh W. Greene, Vice President of the National League of Insured Savings Associations. Mr. Greene, we are very glad to have you, sir.

**STATEMENT OF RALEIGH W. GREENE, VICE PRESIDENT, NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS, ACCOMPANIED BY WILLIAM F. McKENNA, GENERAL COUNSEL AND VICE PRESIDENT**

Mr. GREENE. Thank you, Mr. Chairman.

The CHAIRMAN. And for the benefit of the record, would you disclose who our old friend is who is working with you this morning?

Mr. GREENE. Mr. William F. McKenna, Senator, General Counsel of the League.

The CHAIRMAN. He was for a long time a valuable part of this committee. We always welcome him back, both of you back.

Mr. McKENNA. Thank you, Senator.

The CHAIRMAN. You go right ahead now, if you will.

Mr. GREENE. Senator, my comments will be brief.

On the matter of the State taxation of insured banks, sections 1 and 2 of S. 3652, we would generally support this provision with one reservation in terms of the bill's thrust to prevent discrimination in taxation against insured banks as compared with other financial institutions. We would simply point out or hope to point out that taxation need not be uniform in order to be nondiscriminatory.

If the proposed language in section 24(d)(2) does not allow for such differentiation between different types of financial institutions, then we would have to go on record as opposing the use of such language. This arises in part from the fact that some savings and loans in some States have successfully asserted their exemption from State sales taxes as Federal instrumentalities. It does not happen to be true in my State, but it is true in some.

On the matter of the cashing of Federal checks, I think it would suffice to say that the ground has been reasonably well covered by prior witnesses. I believe we would concur with the statements made by the several gentlemen that commented prior to these comments.

The inherent dangers, of course, of forgery and the collection of dishonored checks becomes a very major matter. There may be one thing the committee might also want to consider that I am not sure has been mentioned. And that is the large amounts of cash that might be required to be held by certain of the smaller institutions in certain areas where you might have military installations, for example, and the risk of the theft, robbery, et cetera, is magnified by the need to have large sums of cash on hand.

If all institutions, FDIC- or FSLIC-insured, were required, without some sort of indemnity, to cash these checks, I think comments made by Mr. Wille on the identification requirements of the Treasury are well taken. And if that protection were afforded, it might, with other proper indemnification for loss by the savings and loan association, become a meaningful thing.

On the question of insurance of public accounts, again, we would concur with the prior testimony given. Generally, we favor adoption of the legislation that would permit savings and loan associations

that are now inhibited in receiving these accounts to receive them and to have the full coverage of insurance.

As a middle ground, the committee and the Congress might wish to consider the possibility, if it did not want to go that far, of following the so-called separate fund doctrine for insurance of public accounts. As you know, under this doctrine, each separate fund in the custody of a public official would be entitled to up to \$20,000 of insurance when held in one or more savings and loan accounts in a single institution, even though a single public official holds custody of more than one separate fund.

As we understand it, under the interpretation given the present law and regulations, Mr. Chairman, if a single public official holds 5 separate funds, as an example, and maintains them in accounts in a single insured institution, the maximum insurance available is \$20,000, the aggregate, rather than \$100,000 for the 5 individual, separate, distinct accounts.

This might be an acceptable compromise approach if there is concern on granting the total coverage.

On the matter of third party loans, an amendment to the bill would alter the provisions of section 408(d)(4) of the National Housing Act dealing with loans a subsidiary insured institution in a savings and loan holding company is permitted to make to a third party to finance purchase of property from a service corporation that is itself a subsidiary of the insured institution.

Presently, these types of loans generally may be made only with prior written approval of the FSLIC, but there are two forbidden categories that would be deleted by the amendment to the bill. One would touch on those cases where the loan would facilitate sale of property purchased from any savings and loan holding company or any affiliate thereof other than the service corporation.

The other would apply where the loan would facilitate sale of property theretofore owned, legally or beneficially, by any savings and loan holding company or affiliate thereof.

With these two exceptions, in all other cases, the FSLIC is directed by existing statute to grant approval for these third party loans if they are not detrimental to the savers of the insured institution or insurance risks of FSLIC.

The amendment offered would delete from the statute the two forbidden categories, but would nonetheless continue to require the written approval of the FSLIC for these types of loans. We feel, Mr. Chairman, this would serve to reduce confusion as to circumstances under which third party loans may be made and would also amount to a recognition of the fact that not all loans in the two categories now prohibited by statute are undesirable from the standpoint of preventing harm to savers in the insured institution or to the FSLIC reserves.

And, in any event, the FSLIC would still sit in judgment on that issue.

In closing, Mr. Chairman, I hope you will permit me to comment just very, very briefly on S. 3248 upon which the Senate has already taken action and which contains a provision relating to State housing corporations for low and moderate income housing. We would hope that if the bill goes to conference, serious consideration would be given

to modification of the provision presently in S. 3248 that relates to banks and savings and loan associations and their ability to purchase stock of and make loans to the State housing corporations.

There has been one set up in Florida under a recent law. We have attempted to present to you a means of adding to the great pool of moneys for housing through private sources. There is provision for that in this bill but the provision is restrictive, we feel, in terms of the moneys that it can produce. We feel in Florida that if the conference committee will adopt our suggested amendment of permitting Federal savings and loan associations to invest up to a quarter of 1 percent of their assets in stock of these private corporations and up to 1 percent of their loans in uninsured loans to these corporations and to invest such amount as they wish in insured loans to the corporations, and the national banks to invest up to 5 percent of their paid-in capital and unimpaired surplus in stock of and loans to these corporations, it will go a long way in helping to solve the very problem that you have given so much direction to over the years, that is, the housing of low-income and moderate-income people, and it will be done by private enterprise with private capital.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Well, thank you, Mr. Greene. I am certainly hopeful S. 3248 will go to conference. As you know, it passed the Senate on March 2, and I believe the House is about ready to take final action on it. Was this particular provision that you referred to just now in the bill as it passed the Senate?

Mr. GREENE. In S. 3248?

The CHAIRMAN. Yes.

Mr. GREENE. Yes, it is.

The CHAIRMAN. I know on the floor of the Senate we inserted some savings and loan legislation, but I did not remember the specific details.

Mr. GREENE. But to refresh the Senator's memory on that, the amendment that was introduced on the floor and became a part of the bill provided—well, first, it applied only to Federal savings and loan associations and it provided that the institutions could invest in the aggregate of loans and stock the lesser of 1 percent of their loans or half a million dollars. Well, I am sure it is obvious to the Senator that a \$50 million institution would have the same investment limit as a billion dollar institution, and we would hope that when it goes to conference, if it gets to conference, that—

The CHAIRMAN. Of course, you realize that if the House passes it as the Senate passed it, there will be no conference on that particular phase. So you had better be doing your work with the House.

Mr. GREENE. I understand. We have been over yonder.

The CHAIRMAN. Fine, I just did not want you to come back and say that we did not treat it in conference the way you wanted. If the House passes it as it is, then there would be nothing in conference.

Mr. GREENE. We are getting some help over there.

The CHAIRMAN. Very well. I assume you would. Now, let me ask you this question. Are not the transactions which would be permitted, should the committee adopt the third party loan provision, subject to possible abuse, in your opinion?

Mr. GREENE. Well, I would have to say, in a general way, that anything is subject to possible abuse, Senator. I think that if you retain the requirement, and certainly this should be retained, that the FSLIC will have to give prior approval on these things based on the criteria that it would not be detrimental to the savers of the insured institution making it or to the insurance risks of the corporation itself, then I think the possibilities of abuse are very remote.

True, they exist, but I think they are remote as long as you insist upon the FSLIC's continued surveillance and supervision and actual written approval.

The CHAIRMAN. In other words, you do think that FSLIC should give special scrutiny to prevent—

Mr. GREENE. Unusual scrutiny.

The CHAIRMAN. By the way, before I forget it, let me ask this question. You suggested that if we are not sure if S. 3652 does eliminate discrimination. You said if it does not, then it should be amended. I do not believe you offered any suggested amendment, did you?

Mr. GREENE. No, we did not. My point was that if discrimination or lack thereof is defined in a manner such that you do not recognize the differential between financial institutions, the structure thereof and the purposes of those institutions, then we would have to oppose it. We do recognize, however, that you can have taxation that is not discriminatory even though it is not uniform.

The CHAIRMAN. Yes. You make that statement in your statement.

(The complete statement of the National League of Insured Savings Associations follows:)

STATEMENT OF RALEIGH W. GREENE, VICE PRESIDENT, NATIONAL LEAGUE OF  
INSURED SAVINGS ASSOCIATIONS

Mr. Chairman and members of the Committee. My name is Raleigh W. Greene. I am President of the First Federal Savings and Loan Association of St. Petersburg, Florida and Vice President of the National League of Insured Savings Associations. I appear on behalf of the National League, a trade association whose primary members are savings and loan associations, to offer the following comments on S. 3652 as amended.

STATE TAXATION OF INSURED BANKS

The National League generally supports the passage of sections 1 and 2 of S. 3652 that deal with taxation of insured banks by States, but expresses one reservation as to some of the wording proposed for section 24(d)(2) of the Federal Deposit Insurance Act as it would be amended by section 1 of the bill. The portion I refer to would provide that no tax may be imposed by a State or its political subdivision upon an insured bank that would "discriminate" against insured banks as compared with other financial institutions coming into competition with insured banks in such State or political subdivision. We have no objection to a prohibition against discriminatory taxation against insured banks, as long as the prohibition does not outlaw the possibility of different tax treatment for different types of financial institutions in recognition of differences in structure or operation, even though such institutions may come into competition with insured banks in certain limited types of operation. In other words, taxation need not be uniform in order to be nondiscriminatory. If the proposed language in section 24(d)(2) I have mentioned does not allow for such differentiation, the National League would feel obliged on behalf of its membership to oppose the use of that language. If any substitute language is employed, it should be such as to admit the possibility of classification of financial institutions for tax purposes on the basis of differences in type of structure and operations.

The National League is content to have sections 1 and 2 deal only with insured banks at this time, because Federal savings and loan associations in some States presently successfully assert their exemption from State sales taxes as

federal instrumentalities. Proposed section 24(c)(1) of the Federal Deposit Insurance Act as proposed in section 1 of the bill would surrender exemption from State and local sales taxes in the case of insured banks.

#### CASHING FEDERAL CHECKS

One of Senator Proxmire's amendments to the bill would prohibit any FDIC-insured bank or FSLIC-insured institution from refusing to honor a check drawn upon the United States Treasury upon presentation by a payee giving adequate identification, on the ground that the payee has no account with the institution requested to honor the check. The amendment would also prohibit that institution from making any charge to the payee for honoring the check. The Secretary of the Treasury would be directed to prescribe implementing regulations before 90 days following enactment of the amendment. The amendment itself would take effect 90 days after enactment.

Although we understand some National League member associations have been reminded by Federal examiners that they are not check-cashing facilities, the associations themselves usually try to accommodate those who present checks for cashing without making any charge to the payee for that service. In doing so, however, they face certain problems the Committee should consider:

1. The difficulty in detecting forgery of the payee's name.
2. The need of an institution that lacks authority to accept demand deposits to keep an adequate supply of cash in till to honor checks presented for payment, a need that would probably increase if the bill becomes law.
3. The additional time taken and expense involved in performing the service of cashing and clearing checks.

While the U.S. Treasury may well be more financially reliable than individual checking account holders, this is no assurance that the Treasury Department will be liable to honor the check. Unfortunately theft of checks drawn on government units is not uncommon. A financial institution that cashes a check endorsed by forgery has no claim against the one on whom the check is drawn. The fact that the bill would excuse dishonoring the check for lack of adequate identification does not remove the problem. The institution cashes a forged check at its own peril. The exigencies of business prevent a microscopic examination of the credentials of all who present checks for payment. Consequently the risk of loss remains. It would be magnified under the provisions of the bill. We have also been informed that because of the long time taken by the Treasury to return checks they do not wish to honor—allegedly up to 18 to 24 months—the payee may well have left the area where the institution is located and be beyond its reach to obtain reimbursement of the funds paid. The bill might be amended to provide indemnity for loss incurred by institutions that must follow its dictates. At least a limit could be placed on the amount of any individual check that would be covered by the bill, in order to reduce the risks involved in cashing checks drawn on the United States Treasury.

Moreover, depending upon the location of the institution, the amount of cash required to honor U.S. Treasury checks could increase to substantial sums. No institution wants to admit it doesn't have enough cash on hand to cash checks. Therefore, it would have to plan ahead if the bill becomes law to assure that it has sufficient cash in till. This may well require the payment of additional expense by the institution for borrowing and transporting the required amount of cash. In turn the larger amounts of cash carried could increase the potential loss through theft, robbery or defalcation. The problem of maintaining fidelity bonds is already troublesome despite precautions taken pursuant to the Bank Protection Act. Limiting the amount of any individual check subject to the bill would help to alleviate these problems.

Depending upon the number of checks presented for cashing, the administrative expense involved in handling the transactions and processing the checks for clearance adds to the cost of doing business. The bill remains silent on how the institution is to meet such costs.

The advantage of cashing checks for a person maintaining an account in the cashing institution is that recovery of losses is more likely than in the case of a person having no account. If that safeguard is to be removed, other protections against loss to the institution should be substituted.

Rather than having regulatory authority vested in the Secretary of the Treasury, we would prefer to see it placed with the Federal Home Loan Bank Board, as far as savings and loan associations are concerned. This would follow the

general pattern of concentrating regulatory authority in the supervisory body that already has a staff of examiners that could check on compliance with a check-cashing statute such as that proposed.

#### FULL DEPOSIT INSURANCE FOR PUBLIC UNITS

Another amendment offered by Senator Proxmire would provide full insurance for deposits or accounts maintained in certain FDIC-insured banks or FSLIC-insured savings and loan associations by listed public units of the Federal, State, territorial, District of Columbia or local governments designated in the amendment. While such full insurance coverage would extend to *Federal* public unit funds placed in any FDIC-insured bank or FSLIC-insured savings and loan association, the coverage would extend to accounts of the other public units designated only if the depository is in the same jurisdiction as the public unit or in the same State in the case of a local public unit.

The amendment would empower FDIC, in the case of insured banks, and FSLIC, in the case of insured savings and loan associations, to limit the aggregate amount of funds any such public unit depositor could maintain in any such insured institution. The limit would be based on asset size of the institution.

Presently such accounts are limited to \$20,000 insurance coverage per insured member, in the case of insured savings and loan associations. Section 401(b) of the National Housing Act gives separate treatment to public unit officials as insured members. For insurance purposes it makes an official of a public unit who has official custody of public funds an "insured member" separate from other officials of the same or a different public unit. Section 405(a) of the National Housing Act limits an insured member of an insured institution to an aggregate amount of insurance not exceeding \$20,000.

The National League continues to support increased insurance coverage for public unit accounts. Therefore it supports adoption of this Proxmire amendment.

As a middle ground, the National League has advocated use of a "separate fund" doctrine for insurance of public unit accounts. Under that doctrine, each separate fund in the custody of a public official would be entitled to up to \$20,000 insurance when held in one or more savings and loan accounts in a single institution, even though a single public official holds custody of more than one separate fund. Under interpretations given the present law and regulations, if a single public unit official holds 5 separate funds and maintains them in accounts in a single insured institution, the maximum insurance available is \$20,000 in the aggregate rather than the \$100,000 it would be under a separate fund doctrine. It would be acceptable if funds of a single public unit could be identified as "separate" only under authority of the governmental body accumulating the funds.

#### THIRD PARTY LOANS

Another amendment of the bill would alter the present provisions of section 408(d)(4) of the National Housing Act dealing with loans a subsidiary insured institution in a savings and loan holding company is permitted to make to a third party to finance purchase of property from a service corporation that is itself a subsidiary of the insured institution. Section 408(d)(4) of the National Housing Act presently allows such third party loans to be made with prior written approval of the Federal Savings and Loan Insurance Corporation except in two categories expressly prohibited by that statute. The 2 forbidden categories are:

(1) Where the loan would facilitate sale of property purchased from any savings and loan holding company or any affiliate thereof other than the service corporation,

(2) Where the loan would facilitate sale of property theretofore owned, legally or beneficially, by any savings and loan holding company or affiliate thereof.

In other cases, FSLIC is presently directed by the statute to grant its approval for the third party loan if the loan would not be detrimental to the savers of the insured institution making it or to the insurance risks of FSLIC.

The amendment would delete from the statute the two forbidden categories noted above, but would still require prior written approval of FSLIC for loans by a subsidiary insured institution to a third party to finance the purchase of property from a service corporation that is a subsidiary insured institution to a third party to finance the purchase of property from a service corporation that is a subsidiary of the insured institution. This amendment will serve to make less confusing the circumstances under which such third party loans may be made. It will also amount to a recognition of the fact that not all loans in the

two categories now prohibited by statute are undesirable from the standpoint of preventing harm to savers in the insured institution or the FSLIC reserves. Under the amendment FSLIC will still sit in judgment on that issue.

The amendment would also permit such third party loans with FSLIC approval where the service corporation is owned by one or more FSLIC-insured institutions. The present provision in section 408(d)(4) applies only where the service corporation is a wholly-owned affiliate of the insured institution. As long as multiple ownership of a service corporation is confined to FSLIC-insured institutions, the owners themselves will be subject to FSLIC regulation. This should prove to be an adequate safeguard to the savers in those institutions and the FSLIC insurance reserves.

The National League urges adoption of the amendment and expresses the hope that the Federal Home Loan Bank Board will implement it with general regulations that afford maximum flexibility of operation of service corporations within the structure of savings and loan holding companies that is consistent with FSLIC responsibilities under the statute as thus amended.

The National League appreciates this opportunity to express its views on the bill and amendments offered to the bill:

The Chairman. Our next witnesses are Mr. Ralph Turlington and Mr. A. Eugene Lewis; Mr. Turlington representing the National Legislative Conference; and Mr. Lewis, special counsel of the Florida Department of Revenue. We are glad to have both of you with us and you may proceed in your own way.

**STATEMENTS OF RALPH D. TURLINGTON, COCHAIRMAN, GOVERNMENTAL OPERATIONS TASK FORCE, INTERGOVERNMENTAL RELATIONS, NATIONAL LEGISLATIVE CONFERENCE, AND CHAIRMAN, COMMITTEE ON FINANCE AND TAXATION, FLORIDA HOUSE OF REPRESENTATIVES; AND A. EUGENE LEWIS, SPECIAL COUNSEL, FLORIDA DEPARTMENT OF REVENUE**

Mr. TURLINGTON. My name is Ralph Turlington and I am here speaking on behalf of the Intergovernmental Relations Committee of the National Legislative Conference. I am cochairman of the governmental operations task force of that committee. I also serve as chairman of the finance and taxation committee of the Florida House of Representatives. I am generally familiar with the issues involved with Senate bill 3652, the American Bankers Association bill, introduced in the Senate by request and without endorsement of the introducer, having previously testified in 1969, when hearings were held on legislation that subsequently became Public Law 91-156.

All that the National Legislative Conference wants is sensible latitude to make adequate and equitable tax decisions on behalf of the citizens and businesses living or operating within the respective States.

With one exception, this was basically achieved in Public Law 91-156. The American Bankers Association bill has two inexcusable inequities. First, it says that a business that is legally organized as a bank in another State can operate in your State and not be subject to any State income tax on its operations outside of its "home office" State. Second, it guarantees to commercial banks every form of tax favoritism provided any business regardless of how its own non-bank competitors are treated. The bill grossly abuses the tax rights of States by guaranteeing to banks unjustified State tax privileges allowed no other profitmaking businesses. The American Bankers Association bill is antibusiness in that it treats all other profitmaking businesses unfairly in comparison with banks. It is a "greedy" bill.

Under this bill, any business legally organized as a bank in another State, can operate in your State and not be subject to any income tax within your State. It can operate in your State 10 loan offices, credit card activities, provide computer services, operate a travel agency or various other activities and pay you no income tax so long as it does not take demand deposits in your State.

This kind of tax discrimination against the other taxpaying business is unworthy of passage even as a temporary measure. If an out-of-State bank opened a loan office in your State or otherwise did significant business within your State, can you imagine how you would explain to the citizens of your States that State and national banks, unlike other corporate businesses are immune by act of Congress from the corporate tax laws of your States?

I know how some might explain it best, by pointing out that Congress has decided to return to special exemptions for banks in comparison with most other taxpaying businesses.

Some ground rules dealing with apportionment of taxable bank income between States is worthy of development, but the passage of legislation prohibiting all State income taxation of an out-of-State bank clearly doing business within your State—making that the status quo—is wrong and will gravely weaken the possibility of passing legislation in the future providing for fair apportionment of taxable income of banks doing business in many States.

Now let us turn to the issue of taxation of bank intangibles by the States. This bill would completely exempt all commercial banks insured by the FDIC from all State and local ad valorem intangible property taxes regardless of how their competitors are taxed.

In Florida there is a 1 mill ad valorem intangible property tax on most intangibles exclusive of deposits. In my hometown one of our automobile dealers does his own car financing and he has outstanding, perhaps, \$2 million of automobile installment loans. For this he is assessed annually the 1 mill tax of \$1,000 per million outstanding or \$2,000. The General Motors Acceptance Corp. makes similar loans and has outstanding perhaps \$100 million for which it also pays \$1,000 per million or \$100,000. A bank with which I place considerable business of this type has outstanding, perhaps, \$10 million on similar automobile installment loans for which they pay nothing.

A representative of the American Bankers Association, June 19 before the House Committee on Banking and Currency, testified that this was fair.

Are banks really different from other businesses in providing on this kind of loan? Of course not.

Let us examine the report of the study under Public Law 91-156 prepared for this committee by the Board of Governors of the Federal Reserve System on the subject of State and local taxation of banks and hereinafter referred to as the study.

In the study it is explained that banks are "vulnerable to an intangibles tax since the duplication of financial assets that is inherent in the flow of savings, first into deposits of those institutions and then into customer loans, would expose savings flowing through intermediaries to an additional layer of taxation not encountered where funds flow directly from savers to ultimate borrowers." This statement from the study is only partly correct, because a review of its logic can only lead

to the conclusion that this "extra layer" would not apply in cases where deposits are not taxed and the taxable loans are limited to direct consumer financing. I think the writers of the study will agree that ad valorem intangible property taxes paid on loans made for installment purchases, such as automobiles, mobile homes, Winnebagos, pleasure boats, and similar direct consumer loans would not be economically or equitably different when paid by banks as compared to General Motors Acceptance Corp., local automobile dealers financing their own paper, or any other businesses financing their own consumer installment sales contracts or "revolving credit."

And if you will examine the testimony of those that are here this morning and look at the ones from yesterday, you will find that they have totally missed this point. They speak in terms of intangibles in a broad general respect and they do not try to get down to the equitable considerations of the individual parts of intangibles. I point this out in my next comments.

The arguments made in the study for recommendation 1 to prohibit taxation of bank intangibles do not take this difference in intangibles into account. Additional language of the study further misses the point as it speaks of possible discrimination "against the process of financial intermediation performed by depository institutions, thus tending to divert flows of savings into direct financing through the market with some consequent loss in economic efficiency." Again, the logic of the study argument applies when a bank makes a loan to a company such as an automobile dealer, or mobile home dealer, or retailer but it does not apply when the bank makes a pleasure boat, mobile home, or automobile loan directly to the purchaser. This portion of bank intangibles should be just as taxable as any other businesses' intangibles.

Just as bank lobbyists have been pointing out in Washington, Tallahassee, Austin, and other capitals that they should not have to pay a tax their competitors do not pay, they should also be pointing out that they should pay the same taxes their competitors pay.

While we believe legislation limiting or restricting bank intangibles by States, unnecessary, unwarranted, and uncalled for and a degradation of States rights, if the Congress feels that some limitation should be written into Federal law, then in any event such restrictions should not apply to all intangibles, but should leave reasonable definitional latitude for States to tax in situations where banks are directly competing for installment loans and their competitors are also equally taxed. I perceive that such language can be written that would be both equitable and administratively workable. The National Legislative Conference and the Florida Department of Revenue, if requested by you, can provide assistance to you in developing such language and we can have our drafting experts quickly available to work with your staff.

Now we come to what should be referred to as the really most humorous part—subsection (d) (2). What can I say about this? I want to find the American Bankers Association attorney who actually wrote this language and present him with a plaque or some other special award!

It should be read at some press club skit—unedited—where the fall guy of the evening's event is some well-known lobbyist seeking—"exclusive tax equity" for his financially grateful clients.

Now, let's turn to subsection (d) (2), which is listed under "Restrictions and Limitations." Remember, these are restrictions and limitations being put upon the States. I am now reading it word for word—let's see how it really sounds. "No tax may be imposed directly—or indirectly—by any State or political subdivision thereof upon any insured bank—or upon its shares—or upon its assets or liabilities—or upon or measured by its gross receipts—or its net income, which by reason of the base on which or rate at which it is assessed, by reason of the manner of its assessment or enforcement, or for any other reason would, by imposing a higher overall tax burden—or in any other respect, discriminate against any class of insured banks—as compared with any other class of insured banks—or against insured banks as compared with mercantile, manufacturing, and business corporations doing business within such State or political subdivision—or against insured banks as compared with other moneyed capital and other financial institutions coming into competition with insured banks in such State or political subdivision.

So, what else is left? Nothing!

The American Bankers Association bill before us is a classic example of special interest legislation. It is to Congress credit that the American Bankers Association was able to get it introduced on only a "by request basis."

Subsection (d) (2) bears out the special interest spirit with which this bill was prepared.

It is abundant with example after example to extract from States for banks every special tax treatment. Subsections (b) and (d) bear out this special interest treatment favoring banks above other businesses, and they are certainly indicative with the thrust of what that association is attempting to do with this type of legislation that is before Congress today.

In subsection (d) the American Bankers Association proposes that the law permanently provide that: (1) any State giving any special tax concession to manufacturing—gives it also unto banks; (2) any State giving any special tax concession to mercantile businesses—gives it also unto commercial banks; (3) any State giving any special tax concession to credit unions—gives it also unto commercial banks; (4) any State giving any special tax concession to savings and loans associations—gives it also unto commercial banks; and (5) any State giving any special tax concession to any business corporations—gives it also unto commercial banks.

Mr. Chairman, Congress would not put up with any such shackles on its own tax legislation nor should it expect the States to put up with this form of harassment written into Federal legislation to prohibit actions that legislatures ought to be entitled to take if they deem it appropriate. We are elected by the people of our States. If we are not doing the job the people can fire us. I stand for election as do other legislators. I stand for election every 2 years. Our Senators stand for election every 4 years. These are policy decisions that should be left to the States. They should not be on the basis of this type of promotion of special interest legislation. The States should no longer be deprived of the opportunity to exercise their best judgment as to how the tax burden should be borne. As long as we are meeting the constitutional

rights that are guaranteed to the citizens and businesses of our States and country, that should be our prerogative, to set the tax burden.

Again, all that we want is sensible latitude to make adequate and equitable tax decisions on behalf of the citizens and businesses living or operating within the respective States. To this end we earnestly urge the support of your committee and Congress in defeating the type of legislation embodied in Senate bill 3652. We are confident that it does not represent the sincere feelings for fairness felt by the rank and file of bank officials, employees or stockholders, or the sentiment of the overwhelming majority of the citizens or taxpayers throughout America.

The CHAIRMAN. Thank you very much, Mr. Turlington.

Do you have a separate statement, Mr. Lewis?

Mr. LEWIS. Yes, sir.

The CHAIRMAN. All right. We will hear from you.

Mr. LEWIS. Mr. Chairman, my name is Gene Lewis, and I am special counsel to the Florida Department of Revenue. I am appearing today on behalf of the Governor of the State of Florida, the Honorable Reubin Askew, and the members of the Florida Cabinet who collectively compose the Florida Department of Revenue, and Mr. J. Ed Straughn, executive director of the department.

The department of revenue is concerned with the proposed draft of Senate bill 3652 because the State of Florida has, in effect, an ad valorem tax on intangible personal property which, but for section 5219 of the Revised Statutes (12 U.S.C. 548), would be imposed to some extent on national and State commercial banks, as well as, effective January 1, 1972, a corporate income and bank franchise tax. Florida also has miscellaneous taxes, such as sales and use taxes, documentary stamp taxes, and real property taxes which apply to all businesses in general, including commercial banks. Therefore, Florida has a direct and vital interest in any Federal legislation that purports to restrict or circumscribe Florida's right to derive reasonable revenue from these sources.

Senate bill 3652 is in substance an amendment and reenactment of section 5219 of the Revised Statutes, as part of the Federal Deposit Insurance Act instead of as part of the National Banking Act. In many instances it is more restrictive than section 5219 as it existed prior to the enactment of Public Law 91-156. The draft is violative of the growing permissive relationship between Federal and State governments in that it reinstates the Federal permission concept of section 5219—that national banks may be taxed only as authorized by Congress and in no other way, and, in addition, for the first time in history, it applies the Federal controls to State banks as well. Even the board in their report to this committee would only impose very limited restrictions on the general powers of State and local governments to tax national and State chartered banks.

The department of revenue is concerned with any restrictions on jurisdiction or division of income rules pertaining to insured banks that would be at variance with rules applicable to other business since uniform administration and enforcement of the tax laws is of prime importance to the department. Let's examine some of the language of the proposed draft dealing with jurisdiction and the division of income rules.

Under corporate income or franchise taxes imposed on businesses generally, multi-State corporate taxpayers are subject to a State's tax jurisdiction if the corporation owns property or derives income from within the State and meets the minimum jurisdiction requirements of Public Law 86-272. The draft bill would preclude the levy by any State of a nondiscriminatory net income or franchise tax on any insured bank—and the term insured bank is specially defined so that it includes commercial banks and it also includes State banks—unless the bank has a banking office, as specially defined, within the taxing State. Banking office is defined in section 24(e) as an office which is authorized to accept demand deposits—that is, checking accounts—and make commercial loans. These provisions mean that the State of Florida, or any other State for that matter, may not levy a properly apportioned income or franchise tax on an insured bank notwithstanding the amount of economic activity or income generated within the State by that bank so long as the insured bank does not offer checking account services and make commercial loans out of an office located within the State of Florida. Thus, an out-of-State bank could set up a suite of offices in Miami, Orlando, or Jacksonville to handle a wide variety of financial services currently offered by banks, in direct competition with taxable local businesses offering the same services, such as commercial loans secured by Florida real or personal property, accepting savings accounts, offering travel agency services and sale of travelers checks, providing full-scale electronic data processing services, leasing real or tangible personal property within the State, offering fiduciary or trust department services, acting as an underwriter of securities within the State, or providing local credit card services, and be completely exempt from income or franchise taxation by Florida, even though Florida has a valid existing income tax or franchise tax imposed by the Legislature of the State of Florida.

This is discrimination pure and simple, without any apparent justification, against other multi-State financial organizations and businesses. The latter entities are subject to a tax in Florida on a properly apportioned amount of their entire income if they have an office in the State or are deriving income from sources within the State. Nothing we have seen aside from this draft bill has even remotely suggested that the above results should be codified in Federal legislation. In fact, even the board's report provided that a State's jurisdiction to tax should not be narrowly restricted.

As another example of the complete Federal protectionist quality of this bill, draft section 24(d) (3) provides that in cases where an insured bank has a banking office located in a State other than the State of its principal office the tax base shall be computed as if the banking office, or offices, constituted a separate bank located within the State.

To persons familiar with State and local taxation, this is simply further assurance that the insured bank can successfully avoid State taxes in cases where out-of-State jurisdiction arises even under the restrictive jurisdictional standards of the banking office concept under the bill. In other words, the term banking office is carefully defined so that under present-day banking and State regulatory practices which prevent interstate branch banking, an insured bank could not and does not maintain banking offices outside the State of its principal offices, and thus it would never be subject to income or franchise tax

jurisdiction other than in its principal office State. There is also a possibility under the definition of banking office in this bill that a bank could avoid the tax in its own principal office State simply by transferring its commercial loan activity outside the State, because both requirements are subject to making commercial loans in the ordinary course of business are required before you have a banking office, which is a prerequisite of taxation under this bill.

But even if for some remote reason the bank accidentally became subject to a State's income or franchise tax jurisdiction, this provision makes it clear that regardless of the unitary nature of the branch's relationship to the principal office and regardless of the other activities conducted by the principal office within the boundaries of the taxing State, such as equipment leasing, credit card services, et cetera, the branch office State can tax only that income derived within its borders from purely banking activities actually conducted by the branch office within the State. This is not the case for the other business corporations where it is recognized that for most businesses net income is the result of many interdependent transactions which transcend State lines and a properly apportioned amount of the total tax base is the fairest measure of tax liability. Even the board in its report recognizes that the apportionment formula approach is the only practical one.

The apportionment problems of the financial institutions we recognize are substantial. We recognize this and we are not in objection to a study by, for example, the U.S. Treasury Department, of reasonable rules for the division of income. However, the types of division of income rules that are encompassed in this bill in effect require States to use a concept known in State and local taxation as separate accounting, which most State taxing authorities, as well as legislatures, as well as any commentators have found that separate accounting just does not fairly represent the total amount of economic activity that is being generated within a State where you have a unitary business.

Further, the drafters of the bill were not satisfied with the blanket exclusion from nonprincipal office State taxation given multi-State banking enterprises under the banking office technique. They apparently thought some State legislature might find it somehow inequitable that out-of-State commercial banks could be the owner-lessors of large amounts of equipment being leased for use within their State or provide a myriad of other essentially nonbank services or functions within the State in direct competition with nonbank institutions who conduct similar activities and are fully subject to the State's corporate income or franchise tax or other similar tax levy, and the commercial banks would be completely exempt from such taxes. Such a legislature might attempt to impose a tax on the commercial operations of the out-of-State bank under section 5(b)(5) of Public Law 91-156. However, even this possibility is explicitly removed by Senate bill 3652. Section 24(c)(5) provides that a State in which no banking offices are located may only levy on insured banks license, registration, or transfer fees or other taxes, except those based on gross receipts or net income, imposed on the ownership, use, possession, or transfer within such jurisdiction of tangible personal property. The emphasized language represents a departure from the language used in Public Law 91-156, and of course exempts equipment leasing transactions from an income or franchise tax. Even the board's study does not remotely suggest

that these types of activities should be exempt from State tax jurisdiction.

The draft refers throughout to taxes imposed directly or indirectly on insured banks. Where restrictions or prohibitions are involved (for example, in subsections 24(b)(2), (c), (d)(2) and (3)) the direct or indirect concept effectively insulates a bank from being considered as a part of a taxable entity composed of a parent and a number of subsidiaries. In many instances, the activities of a parent and its controlled group of corporations are so closely and interdependently related economically that the whole entity must be regarded as a unit for taxation purposes to fairly reflect the taxable base of the entity. This provision might well serve to insulate one-bank holding companies from equitable taxes. For example, under draft section 24(b)(2), no new taxes could be imposed on a one-bank holding company that were not imposed on nonfinancial business corporations in general since the tax could be considered to be indirectly imposed on an insured bank. This result would obtain without regard to whether the activities of the one-bank holding company and its insured bank were so closely related that the fairest measure of the income or other tax base of the holding company would be a consolidated return including all subsidiaries of the company.

Draft section 24(d)(2) contains some of the most striking language in the entire bill where it provides the discriminatory language. As previously has been mentioned, "no tax may be imposed directly or indirectly" by any State which "for any reason" would "in any respect" discriminate among classes of insured banks or against insured banks as compared with mercantile or manufacturing corporations or against insured banks as compared with moneyed capital or other financial institutions coming into competition with insured banks within the State.

Let me just say at this point that the Board of Governors' study has no provision or no recommendation that such provisions as this be enacted by Congress. The Board of Governors simply stated that there should not be discrimination with out-of-State institutions versus in-State. In other words, if you are going to tax-in-State and out-of-State financial or insured banks, then the taxation ought to be equal as between the States, but not within businesses or layers within the State taxing jurisdiction.

Finally, the board of governors recommended that the Federal public debt statute (31 U.S.C. 742) be amended to authorize the inclusion of interest on Federal obligations in the measure of a direct income tax on banks and other depository institutions in the same manner that such inclusion is now authorized for franchise or excise taxes measured by net income. There is really no economic difference between the two types of taxes. This is clearly borne out by the situation present in Florida today. To assure that banks will be clearly taxable on the interest on Federal obligations Florida has a separate franchise tax which applies solely to banks. The tax rate and base is the same as the corporate income tax which applies to corporate businesses generally, which is 5 percent of adjusted Federal taxable income. However, under section 24(b)(2) of the draft, Florida could not adopt its present tax structure after the date of enactment of the draft bill. That section provides that a State may impose only

those taxes upon insured banks which are also imposed on business corporations generally. Since the franchise tax in Florida does not apply to "business corporations generally," it would not be permissible to levy such a tax solely on banks after the enactment even though the economic effect was precisely the same as a similar tax on businesses generally.

We would recommend the repeal of the public debt statute which provides restrictions and provides an artificial distinction about the inclusion of Federal interest in a tax base by a State. A State may easily do so as far as done by enacting a franchise tax and measured by net income as opposed to a direct income tax on that income. However, it requires the enactment of two different separate tax statutes and it requires an additional administrative burden on the taxpayers as well as on the administrative bodies.

Finally, just a couple quick observations concerning the intangible tax. The draft section 24(d) (1) provides for a blanket exemption from taxation of intangible personal property owned by banks. Recommendation 1 of the board provides for a continuation of the present denial of authority for States to impose ad valorem taxes on intangible personal property owned by national banks and goes further to recommend a denial of the right of States to tax their own State banks and other depository institutions. However, the discussion by the board is aimed primarily at reasons for prohibiting intangible taxation of deposits in banks and of notes and other intermediary accounts receivable held by banks. The analysis by the board advances no cogent reasons for denying States, for example, the right to tax shares of stock which may be owned by a banking institution. Further, the reasons advanced by the board in favor of a permanent ban on State taxation of intangible personal property in many cases are not valid when viewed in the light of an intangible tax such as that which is presently imposed by the State of Florida.

For example, the Board states that intangible taxation of national banks will have an adverse effect on bank efforts to gather savings and will in effect result in a double layered taxation since they fear taxation of savings accounts as well as the taxation of the outstanding value of any commercial loans when the savings are loaned out. This would not be the case in Florida since Florida does not now tax money or money equivalents, such as savings accounts or certificates of deposit.

We feel that the solution to equitable taxation of intangibles owned by banks lies in an analysis of the types and sources of intangible personal property held by today's banking enterprises. Thus, intangible property that arises out of direct consumer installment purchase financing by banks should be subject to the same level and rate of intangible tax that applies to nonbanking institutions competing with banks for the installment financing market. On the other hand, items that would be susceptible of double taxation should be exempt from one level of taxation, such as deposits which we have already done.

In short, many of the objections which the Board raises to intangible taxation of banks would be best dealt with through development of an equitable intangible tax base for banks rather than through a complete and permanent exemption of all intangible property owned by banks as provided in draft section 24(d) (1).

Thank you, Mr. Chairman.

(Complete statements of Mr. Turlington and Mr. Lewis follow:)

**FLORIDA HOUSE OF REPRESENTATIVES**

TALLAHASSEE

COMMITTEE ON  
FINANCE & TAXATION  
Room 212, Holland Building  
Tallahassee, Florida 32304

Ralph D. Turlington, Chairman  
John R. Clark, Vice Chairman  
Jim Tait, Staff Director

My name is Ralph Turlington and I am here speaking on behalf of the Intergovernmental Relations Committee of the National Legislative Conference. I am co-chairman of the Governmental Operations Task Force of that committee. I also serve as chairman of the Finance and Taxation Committee of the Florida House of Representatives. I am generally familiar with the issues involved with Senate Bill 3652, the American Bankers Association Bill, introduced in the Senate by request and without endorsement of the introducer, having previously testified in 1969 when hearings were held on legislation that subsequently became Public Law 91-156.

All that the National Legislative Conference wants is sensible latitude to make adequate and equitable tax decisions on behalf of the citizens and businesses living or operating within the respective states.

With one exception, this was basically achieved in Public Law 91-156. The American Bankers Association Bill has two inexcusable inequities. First, it says that a business that is legally organized as a bank in another state can operate

in your state and not be subject to any state income tax on its operations outside of its "home office" state. Second, it guarantees to commercial banks every form of tax favoritism provided any business regardless of how its own non-bank competitors are treated. The bill grossly abuses the tax rights of states by guaranting to banks unjustified state tax privileges allowed no other profit making businesses. The American Banker Association bill is anti-business in that it treats all other profit making businesses unfairly in comparison with banks. It is a "greedy" bill.

Under this bill, any business legally organized as a bank in another state, can operate in your state and not be subject to any income tax within your state. It can operate in your state ten loan offices, credit card activities, provide computer services, operate a travel agency or various other activities and pay you no income tax so long as it does not take demand deposits in your state.

This kind of tax discrimination against the other taxpaying business is unworthy of passage even as a temporary measure. If an out-of-state bank opened a loan office in your state or otherwise did significant business within your state, can you imagine how you would explain to the citizens of your states that state and national banks, unlike other corporate businesses are immune by act of Congress from the corporate tax laws of your states?

I know how some might explain it best, by pointing out that Congress has decided to return to special exemptions for banks in comparison with most other taxpaying businesses.

Some ground rules dealing with apportionment of taxable bank income between states is worthy of development, but the passage of legislation prohibiting all state income taxation of an out-of-state bank clearly doing business within your state -- making that the status quo -- is wrong and will gravely weaken the possibility of passing legislation in the future providing for fair apportionment of taxable income of banks doing business in many states.

### INTANGIBLES TAX

Now let us turn to the issue of taxation of bank intangibles by the states. This bill would completely exempt all commercial banks insured by the FDIC from all state and local ad valorem intangible property taxes regardless of how their competitors are taxed.

In Florida there is a one mill ad valorem intangible property tax on most intangibles exclusive of deposits. In my home town one of our automobile dealers does his own car financing and he has outstanding perhaps \$2,000,000 of automobile installment loans. For this he is assessed annually the one mill tax of \$1,000 per million outstanding or \$2,000. The General Motors Acceptance Corporation makes similar loans and has outstanding perhaps \$100,000,000 for which it also pays \$1,000 per million or \$100,000. A bank with which I place considerable business of this type has outstanding perhaps \$10,000,000 on similar automobile installment loans for which they pay nothing.

A representative of the American Bankers Association, June 19th before the House Committee on Banking and Currency, testified that this was fair.

Are banks really different from other businesses in providing on this kind of loan? Of course not.

Let us examine the report of the study under Public Law 91-156 prepared for this committee by the Board of Governors of the Federal Reserve System on the subject of State and Local Taxation of Banks and hereinafter referred to as the study.

In the study it is explained that banks are "vulnerable to an intangibles tax since the duplication of financial assets that is inherent in the flow of savings, first into deposits of those institutions and then into customer loans, would expose savings flowing through intermediaries to an additional layer of taxation not encountered where funds flow directly from savers to ultimate borrowers." This statement from the study is only partly correct, because a review of its logic can only lead to the conclusion that this "extra layer" would not apply in cases where deposits are not taxed and the taxable loans are limited to direct consumer financing. I think the writers of the study will agree that ad valorem intangible property taxes paid on loans made for installment purchases, such as automobiles, mobile homes, pleasure boats, and similar direct consumer loans would not be economically

or equitably different when paid by banks as compared to General Motors Acceptance Corporation, local automobile dealers financing their own paper, or any other businesses financing their own consumer installment sales contracts or "revolving credit."

The arguments made in the study for recommendation 1 to prohibit taxation of bank intangibles do not take this difference in intangibles into account. Additional language of the study further misses the point as it speaks of possible discrimination "against the process of financial intermediation performed by depository institutions, thus tending to divert flows of savings into direct financing through the market with some consequent loss in economic efficiency." Again, the logic of the study argument applies when a bank makes a loan to a company such as an automobile dealer, or mobile home dealer, or retailer but it does not apply when the bank makes a pleasure boat, mobile home or automobile loan directly to the purchaser. This portion of bank intangibles should be just as taxable as any other businesses' intangibles.

Just as bank lobbyists have been pointing out in Washington, Tallahassee, Austin and other capitals that they should not have to pay a tax their competitors do not pay, they should also be pointing out that they should pay the same taxes their competitors pay.

While we believe legislation limiting or restricting bank intangibles by states, unnecessary, if the Congress feels that some limitation should be written into federal law, then in any event such restrictions should not apply to all intangibles, but should leave reasonable definitional latitude for states to tax in situations where banks are directly competing for installment loans and their competitors are also equally taxed. I perceive that such language can be written that would be both equitable and administratively workable. The National Legislative Conference and the Florida Department of Revenue, if requested by you, can provide assistance to you in developing such language and we can have our drafting experts quickly available to work with your staff.

Now we come to what should be referred to as the really most *humorous part*, -- subsection (d)(2). What can I say about this? I want to find the American Bankers Association attorney who actually wrote this language and present him with a plaque or some other special award!

It should be read at some press club skit -- *un-edited* -- where the fall guy of the evening's event is some well-known lobbyist seeking -- "*exclusive tax equity*" for his financially grateful clients.

## RESTRICTIONS AND LIMITATIONS

(on the powers of states to tax insured commercial banks)

Subsection (d) (2) word for word follows:

"(2) **NO TAX** may be imposed directly - or indirectly - by ANY State or political subdivision there of upon any insured bank, - or upon its shares, - or upon its assets or liabilities, - or upon or measured by its gross receipts, - or its net income, which by reason of the base on which or rate at which it is assessed, by reason of the manner of its assessment or enforcement, or for any other reason would, by imposing a higher overall tax burden -- or in any other respect, discriminate against any class of insured banks -- as compared with any other class of insured banks, --- or against insured banks as compared with mercantile, manufacturing, and business corporations doing business within such State or political subdivision, --- or against insured banks as compared with other moneyed capital and other financial institutions coming into competition with insured banks in such State of political subdivision."

SO WHAT ELSE IS LEFT?    NOTHING!!

The American Bankers Association bill before us is a classic example of special interest legislation. It is to Congress' credit that the American Bankers Association was able to get it introduced on only a "*by request basis*."

Subsection (d)(2) bears out the special interest spirit with which this bill was prepared.

It is abundant with example after example to extract from states for banks every special tax treatment. Subsections (b) and (d) bear out this special interest treatment favoring banks above other businesses, and they are indicative of the spirit with which this bill was prepared.

In subsection (d) the American Bankers Association proposes that the law permanently provide that:

- (1) any state giving any special tax concession to manufacturing, -- gives it also unto banks;
- (2) any state giving any special tax concession to mercantile businesses, -- gives it also unto commercial banks;
- (3) any state giving any special tax concession to credit unions, -- gives it also unto commercial banks;
- (4) any state giving any special tax concession to savings and loan associations, -- gives it also unto commercial banks; and
- (5) any state giving any special tax concession to any business corporations, -- gives it also unto commercial banks.

Congress would not put up with any such shackles on its own tax legislation nor should it expect the states to put up with this form of harassment. Some Florida bank directors have expressed to me amazement at the unfairness of the American Bankers Association's proposals. A number have referred to it as being "ridiculous".

Again all that we want is sensible latitude to make adequate and equitable tax decisions on behalf of the citizens and businesses living or operating within the respective states. To this end we earnestly urge the support of your committee and Congress in defeating the type of legislation embodied in SB 3652. We are confident that it does not represent the sincere feelings for fairness felt by the rank and file of bank officials, employees or stockholders, or the sentiment of the overwhelming majority of the citizens or taxpayers throughout America.

...the ... of the ...



...the ... of the ...



STATE OF FLORIDA  
DEPARTMENT OF REVENUE

TALLAHASSEE  
32304

J. ED STRAUGHN  
EXECUTIVE DIRECTOR

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

My name is Gene Lewis, and I am special counsel to the Florida Department of Revenue. I am appearing today on behalf of the Governor of the State of Florida, the Honorable Reubin Askew, and the members of the Florida Cabinet who collectively compose the Florida Department of Revenue, and Mr. J. Ed Straughn, Executive Director of the Department.

The State of Florida has in effect an ad valorem tax on intangible personal property which, but for section 5219, of the Revised Statutes, (12 U.S.C. 548), would be imposed to some extent on national and state commercial banks, as well as, effective January 1, 1972, a corporate income and bank franchise tax. Florida also has miscellaneous taxes, such as sales and use taxes, documentary stamp taxes, and real property taxes which apply to all businesses including commercial banks. Therefore, Florida has a direct and vital interest in any federal legislation that purports to restrict or circumscribe Florida's right to derive reasonable revenue from these sources.

We feel that Senate Bill 3652 introduced by request of the American Banker's Association, transcends most of the recommendations of the Board of Governors of the Federal Reserve System contained in the Board's report to this Committee and surpasses the areas that should be of legitimate concern to

this Committee and the Congress of the United States. Because of the tremendous inequity that would arise in favor of commercial banks vis-a-vis other business enterprises if the draft bill were enacted and because the draft bill in its present form is so patently contrary to the Congressional intent expressed in Public Law 91-156 and is even contrary to most of the recommendations of the Board of Governors, we feel that the Committee's attention should be directed to some of the obvious practical effects of this draft bill.

Senate Bill 3652 is in substance, an amendment and reenactment of section 5219, of the Revised Statutes, as part of the Federal Deposit Insurance Act instead of as part of the National Banking Act. In many instances it is more restrictive than section 5219 as it existed prior to the enactment of Public Law 91-156. The draft is violative of the growing permissive relationship between federal and state governments in that it reinstates the federal permission concept of section 5219--that national banks may be taxed only as authorized by Congress and in no other way, and, in addition, it applies the federal controls to state banks as well. Even the Board in their report to this Committee, would only impose very limited restrictions on the general powers of state and local governments to tax national and state chartered banks.

ANALYSIS OF PROVISIONS OF SENATE BILL 3652 PERTAINING TO  
JURISDICTION AND DIVISION OF INCOME RULES

Under corporate income or franchise taxes imposed on businesses generally, multistate corporate taxpayers are subject to a state's tax jurisdiction if the corporation owns property or derives income from within the state and meets the minimum jurisdiction requirements of Public Law 86-272. The draft bill would preclude the levy by any state of a non-discriminatory net income or franchise tax on any "insured bank" (as specially defined) unless the bank has a "banking office" (as specially defined) within the taxing state. "Banking office" is defined in section 24(e) as an office which is authorized to accept demand deposits (i.e., checking accounts) and make commercial loans. These provisions mean that the State of Florida (or any other state for that matter) may not levy a properly apportioned income or franchise tax on an "insured bank" notwithstanding the amount of economic activity or income generated within the state by that bank so long as the "insured bank" does not offer checking account services out of an office located within Florida. Thus, an out-of-state bank could set up a suite of offices in Miami, Orlando, or Jacksonville, to handle a wide variety of financial services currently offered by banks, in direct competition with taxable local businesses offering the same services, such as commercial loans secured by Florida real or personal property, accepting savings accounts, offering travel agency services and

sale of travelers checks, providing full scale electronic data processing services, leasing real or tangible personal property within the state, offering fiduciary or trust department services, acting as an underwriter of securities within the state, or providing local credit card services, and be completely exempt from income or franchise taxation by Florida. This is discrimination pure and simple, without any apparent justification, against other multistate financial organizations and businesses. The latter entities are subject to a tax in Florida on a properly apportioned amount of their entire income if they have an office in the state or are deriving income from sources within the state. Nothing we have seen aside from this draft bill has even remotely suggested that the above results should be codified in federal legislation. In fact, even the Board's report provided that a state's jurisdiction to tax should not be narrowly restricted. The present draft leaves a loophole large enough to drive a truck through by providing that a state may tax an insured bank only where an actual branch bank is maintained within the taxing state. As set forth below, this could or would never occur under present banking practices.

As another example of the complete federal protectionist quality of this bill, draft section 24(d)(3) provides that in cases where an "insured bank" has a "banking office" located in a state other than the state of its principal office the tax base shall be computed as if the "banking office" (or

offices) constituted a separate bank located within the state. This is simply further assurance that the insured bank can successfully avoid state taxes in cases where out-of-state jurisdiction arises even under the restrictive jurisdictional standards of the "banking office" concept under the bill. In other words, the term "banking office" is carefully defined so that under present day banking and state regulatory practices which prevent interstate branch banking, an insured bank could not and does not maintain "banking offices" outside the state of its principal offices, and thus it would never be subject to income or franchise tax jurisdiction other than in its principal office state. But even if for some remote reason the bank accidentally became subject to a state's income or franchise tax jurisdiction, this provision makes it clear that regardless of the unitary nature of the branch's relationship to the principal office and regardless of the other activities conducted by the principal office within the boundaries of the taxing state, such as equipment leasing, credit card services, etc., the branch office state can tax only that income derived within its borders from purely banking activities actually conducted by the branch office within that state. This is not the case for the other business corporations where it is recognized that for most businesses, net income is the result of many interdependent transactions which transcend state lines and a properly apportioned amount of the total tax base is the fairest measure of tax liability. Even the Board in its report recognizes that the apportionment formula approach is the only practical one.

The drafters of the bill were not satisfied with the blanket exclusion from non-principal office state taxation given multistate banking enterprises under the "banking office" technique. They apparently thought some state legislature might find it somehow inequitable that out-of-state commercial banks could be the owner-lessors of large amounts of equipment being leased for use within their state or provide a myriad of other essentially non-bank services or functions within the state in direct competition with non-bank institutions who conduct similar activities and are fully subject to the state's corporate income or franchise tax or other similar tax, and the commercial banks would be completely exempt from such taxes. Such a legislature might attempt to impose a tax on the commercial operations of the out-of-state bank under section 5(b) (5) of Public Law 91-156. However, even this possibility is explicitly removed by Senate Bill 3652. Section 24(c) (5) provides that a state in which no "banking offices" are located may only levy on insured banks "license, registration, or transfer fees or other taxes, except those based on gross receipts or net income, imposed on the ownership, use, possession, or transfer within such jurisdiction of tangible personal property." The emphasized language represents a departure from the language used in Public Law 91-156, and of course exempts equipment leasing transactions from an income or franchise tax. Even the Board's study does not remotely suggest that equipment leasing or other non-bank activities of insured banks should be exempt from state tax jurisdiction.

The draft refers throughout to taxes imposed directly or indirectly on insured banks. Where restrictions or prohibitions are involved (for example, in subsections 24(b)(2), (c), (d)(2) and (3)) the direct or indirect concept effectively insulates a bank from being considered as a part of a taxable entity composed of a parent and a number of subsidiaries. In many instances, the activities of a parent and its' controlled group of corporations are so closely and interdependently related economically that the whole entity must be regarded as a unit for taxation purposes to fairly reflect the taxable base of the entity. This provision might well serve to insulate one-bank holding companies from equitable taxes. For example, under draft section 24(b)(2) no new taxes could be imposed on a one-bank holding company that were not imposed on non-financial business corporations in general since the tax could be considered to be indirectly imposed on an insured bank. This result would obtain without regard to whether the activities of the one-bank holding company and its insured bank were so closely related that the fairest measure of the income or other tax base of the holding company would be a consolidated return including all subsidiaries of the company.

Draft section 24(d)(2) contains some of the most striking language in the entire bill. In substance, (d)(2) provides that "no tax may be imposed directly or indirectly" by any state which "for any reason" would "in any respect" discriminate among classes of insured banks or against insured banks as compared with mercantile or manufacturing corporations or against insured banks as

compared with moneyed capital or other financial institutions coming into competition with insured banks within the state. Apparently under this provision, Florida, under its corporate income or bank franchise tax, would have to grant to insured banks the same treatment granted certain business corporations in the State of Florida who qualify as so-called subchapter S corporations for federal income tax purposes (that is, they are exempt from income taxation at the corporate level and thus are exempt from the Florida income tax which is imposed only at the corporate level) because to do otherwise would discriminate against insured banks by "imposing a higher overall tax burden, or in any other respect discriminate" against insured banks as compared with mercantile, manufacturing and other business corporations who elect federal subchapter S treatment. Also, the same reasoning would apply in the case of the statutory bad debt deduction allowed savings and loan associations under the Federal Income Tax Code which is, in effect, a rate reduction since Florida utilizes federal taxable income as the starting point of its corporate income tax base. If such a deduction were not allowed to insured banks, discrimination would occur against insured banks as compared with "other moneyed capital and other financial institutions coming into competition with insured banks in such state." Other similar examples of "discrimination" come readily to mind, as the case of real estate investment trusts, insurance companies, or any other type of industry which is in some degree in competition with insured banks and which because of various federal or state

rules are subject to a different manner of taxation. Even the Board's specific recommendations were limited to the proscription of discriminatory or heavier impositions on out-of-state banks than those applicable in respect to banks chartered by the taxing state. Subsection 24(d)(2) can only lead to the same type of administrative difficulties and litigation that occurred when the moneyed capital and tax rate provisions of section 5219 of the Revised Statutes were introduced.

The Board recommended that the federal public debt statute (31 U.S.C. 742) be amended to authorize the inclusion of interest on federal obligations in the measure of a direct income tax on banks and other depository institutions in the same manner that such inclusion is now authorized for franchise or excise taxes measured by net income. There is really no economic difference between the two types of taxes. This is borne out by the situation present in Florida today. To assure that banks will be clearly taxable on the interest on federal obligations Florida has a separate franchise tax which applies solely to banks. The tax rate and base is the same as the corporate income tax which applies to corporate businesses generally (5% of adjusted federal taxable income). However, under section 24(b)(2) of the draft, Florida could not adopt its present tax structure after the date of enactment of the draft bill. That section provides that a state may impose only those taxes upon insured banks which are also imposed on business corporation generally. Since the franchise tax in Florida does not apply to "business

corporations generally" it would not be permissible to levy such a tax solely on banks after the enactment even though the economic effect was precisely the same as a similar tax on businesses generally.

OBSERVATIONS CONCERNING PROVISIONS OF SENATE BILL 3652 PERTAINING  
TO INTANGIBLE TAXATION

Draft section 24(d)(1) provides for a blanket exemption from taxation of intangible personal property owned by banks. Recommendation 1 of the Board provides for a continuation of the present denial of authority for states to impose ad valorem taxes on intangible personal property owned by national banks and goes further to recommend a denial of the right of states to tax their own state banks and other depository institutions. However, the discussion by the Board is aimed primarily at reasons for prohibiting intangible taxation of deposits in banks and of notes and other intermediary accounts receivable held by banks. The analysis by the Board advances no cogent reasons for denying states, for example, the right to tax shares of stock which may be owned by a banking institution. Further, the reasons advanced by the Board in favor of a permanent ban on state taxation of intangible personal property in many cases are not valid when viewed in the light of an intangible tax such as that which is presently imposed by the State of Florida.

For example, the Board states that intangible taxation of national banks will have an adverse effect on bank efforts to gather savings and will in effect result in a double layered taxation since they fear taxation of savings accounts as well as the taxation of the outstanding value of any commercial loans when the savings are loaned out. This would not be the case in Florida since Florida does not now tax money or money equivalents, such as, savings accounts or certificates of deposit.

We feel that the solution to equitable taxation of intangibles owned by banks lies in an analysis of the types and sources of intangible personal property held by today's banking enterprises. Thus, intangible property that arises out of direct consumer installment purchase financing by banks should be subject to the same level and rate of intangible tax that applies to non-banking institutions competing with banks for the installment financing market. On the other hand, items that would be susceptible of double taxation, such as intermediary loans, should be exempt from one level of taxation.

In short, many of the objections which the Board raises to intangible taxation of banks would be best dealt with through development of an equitable intangible tax base for banks rather than through a complete and permanent exemption of all intangible property owned by banks as provided in draft section 24(d) (1).

FURTHER COMMENTS

We would like to recommend that any forthcoming legislation concerning state taxation of national banks clarifies Congressional intent that state and national banks are to be treated on parity by specifically providing authority to appropriate state and local officials to examine the books and records of a national bank for the purpose of ascertaining the accuracy of any tax return filed by the bank in the same manner that other corporations are subject to examination for tax purposes.

The CHAIRMAN. Thank you very much, Mr. Lewis.

Let me ask just a question or two because we have got two more witnesses and we are going to have a rollcall before too long I am quite sure.

What is the National Legislative Conference? Is that a part of the Governors Conference?

Mr. TURLINGTON. Yes. Our headquarters—our dues, you might say, goes into the same structure as the National Governors Conference, but this is the portion here that is composed of members of the State legislatures. We are having our national meeting this week in New Orleans. We represent all of the legislatures of the United States.

The CHAIRMAN. Very well. I just wanted that to appear in the record.

Mr. TURLINGTON. The Intergovernmental Relations Committee is basically the policy-stating committee for that organization in interim situations. We were not able, of course—our conference will not be voting on resolutions until tomorrow. I am here by authority of the Intergovernmental Relations Committee of the National Legislative Conference and my statement has been read by the chief staff official for that conference whose office is here in Washington, D.C.

The CHAIRMAN. Well, we have a letter from the State of Florida Department of Revenue with reference to Mr. Lewis' appearance and representation. We will place that letter in the record.

(The letter follows:)

STATE OF FLORIDA,  
DEPARTMENT OF REVENUE,  
Tallahassee, July 28, 1972.

HON. JOHN SPARKMAN,  
*Chairman, Senate Committee on Banking, Housing and Urban Affairs, Senate  
Office Building, Washington, D.C.*

DEAR SENATOR SPARKMAN: The bearer of this letter, Mr. Eugene Lewis, is a special attorney for the Florida Department of Revenue and is authorized to appear for and represent this department at hearings by your committee on proposed Federal bank legislation.

Any appropriate courtesies extended Mr. Lewis will be appreciated.

Sincerely,

J. ED STRAUGHN,  
*Executive Director.*

The CHAIRMAN. I wish I had time to dwell on some more questions but I think we had better move on because I want to finish these hearings.

Mr. TURLINGTON. We thank you for holding these hearings and we understand the pressure of the rollcall and other things. We can, given the opportunity, work out a very equitable arrangement in terms of what can be done about the taxation of interstate income, but we basically really have had no opportunity to get very much involved in this and we have had the general recommendations that have come down which different people say this is what the Federal Reserve Board recommended or did not recommend. We can, if your staff will give us just a bit of time, work out proposals that will be fair to the States if, in fact, you feel that this legislation is necessary.

The CHAIRMAN. We certainly will welcome your suggestions and recommendations and the staff will be ready at any time to work with you. Thank you very much.

Mr. Frederick Pownall, California Bankers' Association, will you come around, sir. We have your printed statement, if you will just present it as you see fit. If you will, for the benefit of the record, give the name of the one who accompanies you, it will be appreciated.

**STATEMENT OF FREDERICK POWNALL, CALIFORNIA BANKERS' ASSOCIATION, AND BRUCE KOPPE, BANK OF AMERICA**

Mr. POWNALL. Mr. Chairman, and members of the committee, I am Frederick Pownall, counsel for the California Bankers' Association. With me is Bruce Koppe, vice president and tax manager of the Bank of America.

Our Washington representatives in the American Bankers' Association have indicated in their testimony before this committee the concern of banks with discriminatory taxation at the State level. As they have mentioned, there is another bill concerning State taxation of banks pending in the House and we believe a comparison of the meaning of that bill and S. 3652 illustrates the need for a clear definition in Federal law of what is meant by the term "nondiscriminatory."

S. 3652 makes clear in proposed section (b) (1) that any existing State taxes may be retained so long as different rates or other discriminatory features are not imposed on banks vis-a-vis other business corporations. Section (b) (2) makes clear the standard by which any new taxes imposed on banks will be judged, namely, that they be of general application and be imposed on a uniform and nondiscriminatory basis. The word "rate" is defined in the bill to preclude any ambiguity and the concept of nondiscrimination is fully expressed in proposed section (d) (2).

It should be noted that H.R. 15656 permits any nondiscriminatory tax without specifying what the term means. The need for specific definition here is adequately illustrated by the California case of *Security First National Bank v. Franchise Tax Board*, 55 Cal. 2d 407 (1961), where the California Supreme Court found that there was no discrimination against banks as long as the total tax burden on banks did not exceed the total tax burden on all other business corporations. While this theory seems equitable in the abstract, in practice it is not so. The mere fact that the tax burden theory is applied only to banks and to no other segment of the business community is in itself discriminatory. It is our position and we desire, that banks be subject to any tax applied to business at large but that they not be singled out for application of a totally unique tax system finding no counterpart in any other industry, or be discriminated against by the imposition of tax at a higher rate.

We believe that the thrust of both bills before the Congress supports our position, however, the undefined use of the word "nondiscriminatory" in the House bill would allow the California court's theory to stand, whereas the description of nondiscriminatory in section (d) (2) and the definition of the word "rate" in section (e) (5) of S. 3652 clearly and formally establishes what is meant by nondiscriminatory.

With respect to taxation of banks by nondomiciliary States, section (c) of S. 3652 clearly sets forth that no State may impose any tax on a nondomiciliary bank other than the six taxes listed. The House bill, in section 205, permits the same six taxes by such States, but does not

expressly exclude all other taxes except insofar as section 205 can be read in conjunction with the pertinent part of the policy declaration in section 202. We believe the intent of the House bill is to permit only the six taxes listed, but that the bill is deficient in not clearly setting forth that intent.

The bill before this committee, S. 3652, establishes a clear new formula for taxation of banks by the States. In contrast, the bill before the House, because of its lack of clear definition will unquestionably result in needless tax litigation in future years. S. 3652 answers questions that banks and State taxing authorities have asked since passage by the Congress of the interim proposals of Public Law 91-156 in 1969. The House bill continues to leave these same questions unanswered.

We cannot too strongly emphasize the need for comprehensive bank tax legislation in 1972, and urge the committee's prompt consideration and favorable vote on S. 3652.

Mr. Chairman, I would like to add a few comments to this prepared statement in light of information that we heard yesterday in this committee and indeed some information that we heard this morning. My comments will be very brief.

The CHAIRMAN. Very well. We will be glad to hear you.

Mr. POWNALL. Yesterday, Senator Proxmire made quite a point—and I think it had some impact here—of a distinction between the overall percentage of tax figures or taxes paid by banks as compared with overall taxes paid by business corporations. We have had a few hours to think about that since yesterday's hearing and I would like to make the following statement. This, Mr. Chairman, is with respect to the figures I believe supplied to Senator Proxmire by the Federal Reserve Board in a letter dated yesterday.

The Federal Reserve Board study of State and local taxation of banks pursuant to Public Law 91-156, was submitted to the Senate Committee on Banking, Housing and Urban Affairs in May 1971. That report indicates the difficult problems of comparing the State and local tax burdens of commercial banks with those of other businesses. As stated in that study on page 18, comprehensive data on the tax burden of business generally is not available in the same form in which the information was produced by the Federal Reserve as to the tax expense of commercial banks. Furthermore, difficult conceptual questions as to the types of taxes which can properly be compared and the incidence of various business taxes renders such a comparison meaningless.

The statement made in the hearing yesterday that the State and local taxes paid by all business in 1969 approximated 40 percent of net income before taxes, where State and local taxes paid by commercial banks in 1969 approximated only 10 percent of income before taxes, is derived from statistics in Governor Mitchell's letter to Senator Proxmire dated August 1. Governor Mitchell's letter indicates the problems of comparison and methodology involved in the enclosed statistics.

Those statistics indicate that in 1969 all business paid approximately \$57.3 billion in taxes to State and local governments and that the net income before taxes for all business in 1969 was approximately \$184.1 billion, or a ratio of taxes to income of 40 percent, the

figure cited in this hearing. By comparison, the Federal Reserve Board study of tax expense in 1969 would indicate that commercial banks paid \$0.623 billion in State and local taxes and that their pretax income for the same year was \$6.7 billion, or a ratio of approximately 10 percent.

The above figures are, as indicated in the Fed's 1971 study, misleading if employed on a comparative basis. For example, the figure of corporate profits before taxes is generally predicated on income before income tax. This figure has generally been adjusted for taxes such as property taxes, sales and use taxes, employment taxes, et cetera, which may be included in the cost of goods sold. Thus, in the case of business generally, sales and use taxes for 1969 comprise \$15.1 billion of the \$57.3 billion total business taxes paid. In other words, sales and use taxes were 25 percent of the total State and local taxes.

In the case of commercial banks, however, sales and use taxes were \$0.018 billion of a total of \$0.623 billion of State and total taxes paid by commercial banks, a ratio of approximately 3 percent.

If taxes as a percent of pretax income are to be compared for commercial banks and business generally, the proper comparison should be income taxes paid to State and local governments as a percentage of pretax income. On this basis, the statistics submitted to Senator Proxmire by Governor Mitchell would show the following: All business

$\frac{3.5 \text{ billion}}{152.1 \text{ billion}} = 2.3 \text{ percent}$ ; commercial banks  $\frac{.235 \text{ billion}}{6.7 \text{ billion}} = 3.5 \text{ percent}$ .

Now, that certainly is a different story, using the same figures that were deduced from the information given yesterday, and we would like the committee to consider that difference.

With respect to some of the questions today, Mr. Turlington from Florida had several points that I think I should briefly comment on.

The basic question: Are banks different from all other business corporations, we must answer in the affirmative. The reason they are different from all other business corporations is because they are using your money and my money, unlike say, General Motors Acceptance Corp., or Commercial Credit Corp., the examples cited, which are using the corporation's own funds for investment purposes.

With respect to the interstate taxation issue and the six taxes that would be permissible under both the Fed's bill and S. 3652, on behalf of the California Bankers' Association, I would like to say that as soon as the formula for interstate apportionment of income can be worked out by this Congress, the prohibition in these bills undoubtedly, will be lifted by you, and we, undoubtedly, will support the lifting of that prohibition.

I think that we and the committee have to take notice that the Congress has labored for over 10 years to try and arrive at an apportionment formula for business generally as to interstate taxation of corporations. It is an immensely difficult issue. I can tell you from a brief study that I did 2 years ago that it is just as difficult and complex, if not more so, with respect to the banking business because of the special nature of the business, the interstate exchange of funds.

With respect to taxation of intangibles, there were certain points that have to be mentioned. The reason that both the Fed study, the American Bankers' Association and our member group supports the two bills before the Congress and the prohibition of taxation of intan-

gibles is because the question of situs of such intangibles for the most part is an open one in State law. Is a loan to be taxed at the location of the borrower or the location of the lender or the location of the making of the transaction, that type of question. The law in different States differs and I think the Federal Reserve and the people that drafted this bill were taking the differences in the State laws into consideration in putting this prohibition into the law.

As pointed out in the Florida figures, the home State very often does not or has a constitutional provision against taxing its own issues. This is true in California, also. So when we talk about allowing a State to tax, say, securities, municipal and local bonds, for the most part that State would not be taxing its own securities held by banks, but taxing securities of other States held by its own bank. Thus, such a tax could very well be discriminatory against the smaller, less commercial States and in favor of the larger, commercial States where the larger, commercial banks are located, which, by far, provide the largest market for such State and local issues.

With respect to the last point—and this is my last point—that the Congress here is restricting the States' ability to tax banks, I think we all are aware that the Congress has restricted that ability with respect to national banks for something approaching 110 years. Now, we therefore are not embarking on a new program if such a law as S. 3652 is put into law. On the contrary, we are opening up whole new areas of taxation by the States and limiting them in very narrow areas with respect to intangibles and with respect to interstate taxation.

The income from such intangibles obviously can continue to be taxed if the State desires to construct its law accordingly. California has done so and the franchise tax in California includes in its measure income from what usually are described as tax-exempt bonds.

That concludes my statement, Mr. Chairman.

The CHAIRMAN. Well, thank you very much. We are very glad to have your statement.

Mr. Koppe, do you have anything to add?

Mr. KOPPE. No, I do not. If you have any questions, I will help Mr. Pownall answer them.

The CHAIRMAN. Well, we appreciate you coming. We are glad to have had both of you.

The next witness will be Mr. Tom Bane, president, Council of Savings and Loan Stock Companies. Mr. Bane, we are very glad to have you, sir. We have your statement, so you may move right along in presenting it.

#### STATEMENT OF TOM BANE, PRESIDENT, COUNCIL OF SAVINGS AND LOAN STOCK COMPANIES

Mr. BANE. Mr. Chairman, I appreciate the time you are giving us today. My statement will be very brief.

This amendment or a similar amendment as this was before this committee and adopted by both the Senate and the House and became effective January 1, 1971. I would like at this time, if I could, to offer some excerpts that I have compiled from the Congressional Record which involved the floor debate.

The CHAIRMAN. Without objection, it will be printed in the record.

(Excerpt follows:)

[From the Congressional Record—House, Dec. 3, 1970]

(Pages H11092—H11095)

AMENDMENT OFFERED BY MR. SISK TO THE AMENDMENT IN THE NATURE OF A  
SUBSTITUTE OFFERED BY MR. STEVENS

Mr. SISK. Mr. Chairman, I offer an additional amendment to the amendment in the nature of a substitute.

The Clerk read as follows:

Amendment offered by Mr. SISK to the amendment in the nature of a substitute offered by Mr. STEPHENS: On page 113, after line 15, insert:

"SEC. 916. To amend section 408(d) (4) (B) of the Savings and Loan Holding Company Amendments of 1967 by striking the semicolon at the end of paragraph 4 and inserting in lieu thereof: 'Provided, however, That with the prior written approval of the Corporation, a subsidiary insured institution may make a loan, discount or extension of credit to a third party on the security of property acquired from a wholly-owned affiliate service corporation. The Corporation shall grant approval of any application for approval under this subdivision if, in the opinion of the Corporation, such loan, discount or extension of credit would not be detrimental to the interests of savings account holders in the insured institution, or to the insurance risk of the Corporation with respect to such institution, and would not be a means of facilitating the sale of (1) property purchased from any savings and loan holding company or any affiliate thereof other than such service corporation, or (2) property heretofore owned, legally or beneficially, by any savings and loan holding company or affiliate thereof.'

Mr. SISK (during the reading). Mr. Chairman, I ask unanimous consent that the further reading of the amendment be dispensed with, and that it be printed in the RECORD.

The CHAIRMAN. Is there objection to the request of the gentleman from California?

There was no objection.

Mr. SISK. Mr. Chairman—

Mr. BARRETT. Mr. Chairman, will the gentleman yield?

Mr. SISK. I will be glad to yield to the gentleman from Pennsylvania.

Mr. BARRETT. Mr. Chairman, we are familiar with this. This is identically the same amendment offered by Mr. HANNA of our committee.

Mr. SISK. That is correct. I am offering this amendment, I might say, in behalf of the gentleman from California, Mr. HANNA, who was unable to be here today, and I understand it has been considered by the committee.

Mr. BARRETT. Mr. Chairman, we have no objection to the amendment.

Mr. SISK. I thank the gentleman.

Mr. WIDNALL. Mr. Chairman, will the gentleman yield?

Mr. SISK. I will be glad to yield to the gentleman from New Jersey.

Mr. WIDNALL. Mr. Chairman, I thank the gentleman for yielding.

For the purpose of the record, Mr. Chairman, would the gentleman capsulize the purpose of the amendment?

Mr. SISK. I will be happy to. I thank the gentleman for his comment.

Let me say, Mr. Chairman, that the primary purpose of this amendment, as I understand it, is to make equal certain companies in the savings and loan business. Under existing law a savings and loan not involved in a holding company can perform certain kinds of services in connection with the development of housing in connection with third party dealings, but a savings and loan company as a part of a holding company cannot. And what this would do would put them on a parity and make possible exactly the same kind of operation for a savings and loan company that was a part of a holding company as would be permitted for a savings and loan company that was not a holding company.

Mr. WIDNALL. Mr. Chairman, would the gentleman yield further?

Mr. SISK. I will be glad to yield further.

Mr. WIDNALL. Mr. Chairman, is this the same section of the Emergency Home Finance Act that was knocked out in conference?

Mr. SISK. It is my understanding it is identical.

Mr. WIDNALL. As far as I am concerned, we have no objection to the amendment on the minority side.

Mr. SISK. I thank the gentleman very much.

(Mr. Sisk asked and was given permission to revise and extend his remarks.)

Mr. SISK. Mr. Chairman, the sole purpose of this amendment is to update and make uniform the Federal savings and loan law.

My amendment would alter Public Law 90-255, the savings and loan holding company amendments enacted in 1967. When we passed that statute we could not foresee the developments which were to come in the savings and loan business. One of the most important innovations has been the advent of the service corporation as a means of encouraging increased home building. Savings and loans were given broadened authority to use service corporations by regulations adopted by the Federal Home Loan Bank Board in August of this year. However, the prohibitions included in Public Law 90-255 have barred some savings and loans from using the authority fully and effectively in one important respect. Most savings and loan associations are allowed to make loans to third parties who wish to purchase homes built by the association's corporation. The language of Public Law 90-255, however, prohibits holding companies owned savings and loans from financing housing constructed by their service corporation. This is the condition which I propose to correct.

My amendment would let any savings and loan association finance housing sold by its wholly owned service corporation. The amendment will help us progress toward the goal we all seek of a decent home for every American by permitting the full and effective use of service corporations by all savings and loans.

In conclusion, let me say I am aware of the need to guard against the abuse of the authority. This potential problem has caused me to include four important safeguards in my proposal. The first limits such transactions to circumstances where the service corporation is owned entirely by the savings and loan. This will insure that all profits from a sale to a third party basen on financing offered by the savings and loan will go to the savings and loan.

The second protection provides for prior written approval of the Federal Home Loan Bank Board before a savings and loan extends credit to a third party on security of property purchased from the service corporation of the savings and loan doing the financing. This requirement is a heavy one. It may prove unnecessary. I would, however, prefer to see it in the law until we understand better what the development of service corporations will bring.

A third check is provided by language barring the use of the authority to benefit directly or indirectly, any entity other than the Service Corporation of its parent savings and loan. Finally, the authority granted by this amendment is subject to the strong conflict-of-interest regulations applicable to all savings and loans. These four safeguards will, I am confident, insure against abuse or misuse of the authority granted.

The Federal Home Loan Bank Board reviewed this legislation, in fact participated in its drafting, and has no objection to it.

In summary, my amendment makes a minor adjustment in the savings and loan law. However, the change is important to the full utilization of an important means of delivering adequate housing to America, the Savings and Loan Service Corporation. Whatever possible risks might be engendered by permitting all associations to loan to third parties on security of property purchased from the Service Corporation are eliminated by a series of safeguards embodied in my proposal.

Mr. ST GERMAIN. Mr. Chairman, I move to strike the requisite number of words.

Mr. Chairman, something should be cleared up. At least I am a little concerned about it. Getting back to the amendment before us, offered by the gentleman from California (Mr. SISK), amendment No. 2, the gentleman from New Jersey inquired of the gentleman from California if this were the amendment that has been knocked out in conference.

The answer was in the affirmative. I think for anyone reading the deliberations of this House, without giving any further explanation as to why it is now acceptable when it had been knocked out in conference last year—I do not think this RECORD reads properly. I feel that it is imperative and important that if there are any differences between the pending amendment and that which was knocked out in conference, these should be pointed out. The reasons should be pointed out. The reasons should be given for its having been knocked out originally and why it should be acceptable at this time.

Mr. SISK. Mr. Chairman, if the gentleman will yield to me, I would like to make one brief comment, and I am sure the gentleman from New Jersey would like to comment. I might comment that I appreciate the question raised by the gentleman.

It is my understanding this was included in the bill last spring, and I am sure the gentleman is far more familiar with that bill than I am, because the gentleman knows, I am sure, that we were shaping a bill having to do with emergency financing. This amendment was put on it at that time by the gentleman from California (Mr. HANNA). The reason, I am told by my staff people, that it was stricken is that it really did not belong in a matter of emergency financing, and it should be considered more as a policy matter in connection with new authorization. That was the reason, I am told, that it was stricken from the bill—not because of any basic objection to the principle of policy established, but it was stricken because it was a policy matter and did not belong in that bill.

Mr. ST GERMAIN. May I ask, am I to understand that this grants powers to a savings and loan association that is part of a holding company so it will have the same power that a savings and loan has that is not part of a holding company, or is it the other way around?

Mr. SISK. In other words again, it puts the savings and loan that is part of a holding company—that is a wholly owned part of a holding company—this would put it on an equal basis with a savings and loan today that is not part of the holding company. It simply brings the holding company of the savings and loan in line in connection with third-party dealings and subjects it to the approval by the Home Loan Bank Board on a case-by-case basis.

Mr. ST GERMAIN. But it is not giving any more powers. It is just giving equal powers?

Mr. SISK. That is correct.

The CHAIRMAN. The question is on the amendment offered by the gentleman from California (Mr. Sisk) to the amendment in the nature of a substitute offered by the gentleman from Georgia (Mr. STEPHENS).

The amendment to the amendment in the nature of a substitute was agreed to.

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[From the Congressional Record Dec. 19, 1970]

(Page H12133)

Mr. HANNA. Mr. Speaker, I say to the gentleman from Pennsylvania (Mr. BARRETT), I note that section 821 of the House-passed version of the bill is now section 920 of the bill agreed to by the conferees. This is the section dealing with the relationship between savings and loan associations which are controlled by holding companies, and the service corporations of these savings and loan associations. There is a technical aspect of the legislative language which I believe needs some clarification. The language does not specifically spell out the purposes for which the proceeds of the loan, discount, or extension of credit received by the third party may be used. I understand it was intended that the proceeds of the loan, discount or extension of credit granted by an association to a third party on security of property acquired from the service corporation could be paid over to the service corporation in consideration for the property as well as services rendered by the corporation in connection with the transaction. Would the gentleman kindly advise me as to whether my understanding of this is accurate?

Mr. BARRETT. Yes; that is the intention of the legislation. The language of the section will extend equal powers to all savings and loan associations, whether under holding companies or not, in their dealings with their service corporations and its dealings.

Mr. HANNA. Then I assume all savings and loans and their service corporations will be able to operate under policies now in effect.

Mr. BARRETT. That is correct. At this point I wish to include the Bank Board regulations relating to service corporations:

Mr. BANE. I will deal only with the amendment relating to third party loans that is being offered by Senator Tower and Senator Cranston.

This third party loan talks about a loan that the insured institution wishes to make to a home buyer when that home buyer is buying that house from a subsidiary of the insured institution. That is a very narrow area and a very narrow field. It was said that this would benefit those that are affiliated with a holding company. This amendment is in the spirit and the philosophy of the Holding Company Act and I think it is in the spirit of providing housing to the public at the lowest possible cost.

All associations chartered by the Federal Government, State-chartered mutual associations and State-chartered capital stock associations which are not affiliated with holding companies are allowed to make these types of loans. The only ones that are excluded from doing so are those affiliated in any way with a holding company. There is no evidence that there has been any abuse as far as all these other associations are concerned, and there is less probability that there would be abuse if performed by those associations who are affiliated with a holding company.

We urge that the committee look favorably upon this amendment of Senator Tower and Senator Cranston.

That concludes my statement, Mr. Chairman.

(Complete statement of Mr. Bane and a statement from the National Association of State Savings and Loan Supervisors follow:)

STATEMENT OF TOM BANE, PRESIDENT, COUNCIL OF SAVINGS AND LOAN STOCK COMPANIES

Mr. Chairman, we greatly appreciate the opportunity and time you are giving us today to discuss the issue of third-party loans. We reluctantly support the bill before you which was drafted under the guidance of the Federal Home Loan Bank Board. It takes only a small step toward giving parity to State-chartered savings and loan associations which are affiliated with holding companies.

The bill eliminates some of the flat prohibitions against certain transactions presently in the statutes but subjects those transactions to prior approval of the FHLBB. Congress attempted once before to eliminate these prohibitions but the draftmanship of the bill prepared by the FHLBB and enacted by Congress was so complex that it frustrated the intent of Congress and lawyers maintain that the statute is incapable of interpretation.

The amendment before you has been more carefully drafted and reviewed and clears up the confusing language of the prior amendment. Although we fear a continuance of the repressive and narrow rulings issued by the FHLBB, we fear that to do anything other than support this amendment would just leave us with the old language which is still incapable of interpretation.

The amendment deals with third-party transactions. A third-party transaction pertains to the sale of housing which is developed and sold by a subsidiary of the savings and loan and financed by the parent savings and loan. Because there are two legal entities of the savings and loan complex involved, the buyer becomes identified as the third party.

The present restriction on such transactions was inadvertently included in the original holding company bill. I say inadvertently because it was before the present method of developing housing was being utilized. One negative aspect of this unfortunate restriction is that it has prevented holding companies from fully participating in the development of low-cost housing and implementing legislation which Congress created to increase the low-cost housing supply.

Holding companies should, and can be of assistance to their subsidiaries. When the opportunity arises to assist them in providing housing and strengthening the savings and loans, it is logical for them to be allowed to do so. I realize that Congress may fear that some transactions might not result in being helpful to the savings institutions. The requirement of prior approval of the FHLBB will prevent any transaction from occurring which is not beneficial to the savings and loan.

It is this requirement of prior approval of the FHLBB that causes us some concern. Such transactions, if carried on by mutual institutions or plain capital

stock associations, require no approval. There is no reason that such transactions when performed by holding company affiliates should be treated any differently. The FHLBB is noted for its tendency to interpret statutes and regulations extremely narrowly. It certainly has been overly restrictive regarding the activities of the capital stock institutions, and this is difficult to understand. The capital invested by the shareholders stands between the insured institution and the FSLIC.

For some reason the staff of the FHLBB has been extremely antagonistic to holding companies and for that matter antagonistic to capital stock associations. It seems that the attitude is that the mutual savings and loans are the purest, less pure are the capital stock companies and worse yet are the holding companies. A review of the facts regarding the operation of the three categories reveals that the exact opposite is more likely to be true.

Let us examine the structure of the three, especially with regard to the laws that govern them and the motivations of their management, and how these motivations affect the public and the FSLIC.

Let us consider the outside activities of the management which may result in a conflict of interests. The operation of insurance agencies is a good example, but it is only an example because there are many side activities that result in the same conditions.

Most of the managers of mutual savings and loans have long operated their own insurance agencies, the total profits of which they put into their own pockets. Keep in mind that in a mutual savings and loan there are no stockholders and consequently no investment by management. The resources of the mutual savings and loans are the funds of the depositors which are insured by FSLIC.

Where does the interests of a mutual manager lie? With the profitability of his own insurance agency or the profitability of the savings and loan? With just this brief comment regarding mutuals in mind, let us turn to the capital stock company in which the original investors may have to put up two million dollars of their own money before the FSLIC will grant federal insurance of accounts. You can readily see that the soundness and profitability of their savings and loan is of great concern to its stockholders, and they will watch management carefully to be sure that the savings and loan is properly operated. However, even in this case activities not allowed to the savings and loan can be engaged into on the side by those in control of the association. Again the insurance agency example is a good one, except in this case the profits are generally divided among the directors of the capital stock savings and loan. Thus, the directors receive larger benefits from their investment than do the ordinary stockholders.

Now let us look at the holding company structure. For the directors to engage in an activity related to the savings and loan business is a violation of corporate opportunity. This results in the profits from all of the operations related to the savings and loan business being distributed to stockholders in direct proportion to their investment. In addition to that, the holding company finds itself without any exemptions whatsoever from S.E.C. laws and regulations. It is subject to all state and federal corporation laws and particularly the laws that protect stockholders from being short-changed because of conflict of interests or dereliction of duties on part of the management.

It is quite apparent that the form of organization most apt to lead to the elimination of self-dealing or conflicts of interests is the holding company structure.

It is important to mention that besides being the purest form of organization, the holding company structure generates more money for housing than the two other forms. The profits from the related activities carried on within the corporate structure instead of outside of it are put right back into housing. Except for an extremely few and minor exceptions, savings and loan capital stock institutions do not pay cash dividends. Investors in them are seeking growth stocks. In order to grow, capital stock savings institutions must reinvest their profits into housing. State laws demand that they must have a certain net worth. Some require up to 5% of their savings accounts. A capital stock savings institution must maintain a higher net worth than required, or they will be unable to accept any new savings accounts. If they can't accept any new savings accounts, they cannot make new loans to provide more housing. Every dollar of new net worth obtained by the capital stock association, whether by a contribution from its parent holding company or profits from its operations, allows it to take in 20 times that in new savings accounts. It is quite apparent why capital stock savings institutions do not pay dividends but instead place their profits back into housing. This again points up the need for encouraging the holding company concept in

the savings and loan business organization instead of discouraging it. This may be peculiar to no other business, but it results from the fact that savings and loan holding companies have such a strong motivation for reinvesting their profits into the business that they do not pay dividends. If they do pay them, it is in the form of stock dividends and not cash.

Although the amendment offered is quite minor, if the FHLBB is reasonable in its interpretation and application it will be of assistance in providing housing at the most reasonable cost.

Before a house is ready for occupancy, many things must happen. Raw land has to be prepared by subdividing, grading and completing off-site and on-site improvements. If it is a tract development which is, cost-wise, one of the cheapest ways to develop housing, much coordination is needed in all of the activities involved before the housing is ready for the buyers. A long period of time elapses between the start of developing the land and when the home is ready.

The methods used in developing housing vary according to the area of our nation and to the need of the population in those various areas. These methods will change as time goes by because the housing industry like other industries must and does search for more efficient, more economical and more competitive methods in developing the housing to meet our nation's needs. To keep flat prohibitions in the statutes means that every time a new developing or marketing technique is used, Congress would have to change the statutes. Our nation's economy moves too fast for that and Congress is constantly being faced with more and more critical decisions to make. Unless there is some flexibility, the savings and loan organized under a holding company concept will continually find itself at an extreme disadvantage in trying to compete. Keeping down such competition can do nothing but raise the cost of housing to the populace. Families of today have too many needs to create procedures that increase the cost of their housing.

The present amendment is agreed to by the United States Saving and Loan League, the National Association of Insured Savings Associations, and our Council which is also a national organization.

The amendment, of course, affects only a small section of the holding company act, and we would like it to do more. We will in all probability present more extensive amendments to you at a later date whether or not they meet with the approval of the FHLBB. But we were advised by various Congressmen that now is not the time because there are more important items on the agenda of Congress. So you have before you an amendment similar to one you passed before, doing the same thing you intended the last one to do. I think all of us owe you an apology for that, and that is one reason all of the trade associations have agreed with the Federal Home Loan Bank Board on this clearer version of their approach to legislation dealing with property developed by a subsidiary of a savings and loan and financed by its parent savings and loan.

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STATEMENT OF FRANK R. GAILOR, COUNSEL, NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS

My name is Frank Gailor and I appear here as Counsel to the National Association of State Savings and Loan Supervisors.\* Our purpose is to elaborate a problem facing state chartered savings and loan and explain how S. 3652 might be amended to vitiate the problem.

The problem is that the laws of a number of states tend to discriminate against lending operations by institutions not located within their respective borders. Indiana, Iowa and Missouri—for example—have effectively precluded Illinois based institutions from lending within their borders. Iowa, Missouri and Indiana have legislated onerous "doing business," privilege and other excises which apply only to non-domiciliary institutions. The presence of these barriers

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\*The members of the National Association of State Savings and Loan Supervisors regulate state chartered savings and loan and mutual thrift institutions in the several states and the territories. They oversee over 3,500 savings institutions having assets in excess of \$80 billion. The principal officers of the National Association of State Savings and Loan Supervisors are W. Sale Lewis, President of the Association and Savings and Loan Commissioner, Texas; Donald D. Swone First Vice President of the Association and Deputy Savings and Loan Supervisor, Illinois; Tom D. McEldowney, Second Vice President of the Association and State Bank Supervisor, Idaho; Michael F. B. MacBan, Chairman of the Legislative Committee of the Association and Savings and Loan Commissioner, California; Walter Bullock, Vice Chairman of the Legislative Committee and Executive Officer of the Savings and Loan Board, Mississippi.

has predictably discouraged lending in the three states by Illinois institutions. Illinois savings and loans bordering on these States are greatly handicapped by such discriminatory levies. Such institutions may lend only within a 100 mile radius of their home office. To the extent the circumscribed area is within Indiana or Iowa or Missouri the institution's lending territory is diminished. Attempts have been made through national savings and loan trade groups, the Governors' and Attorneys General Conferences to eliminate such discriminatory practices. To date these efforts have been unavailing.

There is only one way in which State chartered savings institutions can, under present law, escape such excises as these and concomitantly secure greater operating authority. By relinquishing their State charters and converting to Federal savings and loan charters they can secure the protection of Federal Law from discriminatory levies. Several associations have sought out that sanctuary with the resultant weakening of the dual system of savings and loan chartering. The National Association of State Savings and Loan Supervisors fears, and with good cause, that a failure to address the problem of discriminatory taxation could ultimately result in the demise of the system of state charter savings and loans.

The problem described is not without parallel, a total of ten States impose excises which discriminate against non-domiciliary institutions. The study of "State and Local Taxation of Banks" commissioned by the Committee on Banking, Housing and Urban Affairs noted this. The third recommendation emanating from that study was on discriminatory taxation and called for the proscription of:

"discriminatory or more onerous license, privilege, or other similar "doing business" taxes upon out-of-state depository institutions than would be imposed upon these institutions if chartered by the taxing State. The provision might take the form of a specific limitation, under which an out-of-state corporation or association could not be required to pay a higher license, privilege, or other "doing business" tax or fee than it would pay under the same circumstances if it were domiciled or chartered in the taxing State."

Surprisingly, however, the legislation introduced to implement the Study recommendations does not extend to all depository institutions. Instead, it is addressed only to insured banks. Notwithstanding recommendations by the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board that it be extended to banks, savings and loans and mutual savings banks.

There are provisions in S. 3652 which, if made applicable to all depository institutions, could relieve the problem described. Section "(c)" bars the imposition on an insured bank not having its banking office within the taxing jurisdiction of any tax unless imposed generally throughout such jurisdiction on a uniform and nondiscriminatory basis. This provision would help vitiate the problem described were the language of the bill amended to include savings and loans. An amendment to accomplish this follows:

"AMENDMENT TO S. 3652

"On page 5, strike lines 24 and 25. On page 6, strike lines 1 through 7. Insert in lieu of the foregoing:

"Deposits in which are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation."

"(2) 'Banking Office' means any office of an insured bank."

On behalf of the National Association of State Savings and Loan Supervisors, I respectfully request this amendment be made to 3652.

The CHAIRMAN. Thank you very much, and that concludes the hearings for this morning. In fact, it concludes the hearings on this proposed legislation, and the committee will stand adjourned.

(Whereupon, at 12:15 p.m., the hearing was adjourned.)

STATEMENT OF FRANK CARRINGTON, EXECUTIVE DIRECTOR AMERICANS FOR EFFECTIVE LAW ENFORCEMENT, INC.

Mr. Chairman: My name is Frank Carrington. I am the Executive Director of Americans for Effective Law Enforcement, Inc. (AELE). I am an attorney and hold a Masters of Laws Degrees in Criminal Law. I have spent approximately

ten years in law enforcement including six years as a Special Agent (Criminal Investigator) with the Intelligence Division, Internal Revenue Service, U.S. Treasury Department, engaging primarily in organized crime investigations. I appreciate very much the opportunity to testify before this Subcommittee.

Americans for Effective Law Enforcement, Inc. (AELE) is a national, not-for-profit, citizens organization the purpose of which is to give responsible support for proper law enforcement. We believe that the two bills S. 3814 and S. 3828 currently being considered by the Subcommittee will have a direct and adverse impact upon law enforcement in this country and so take this opportunity to present this Subcommittee with our views.

As the name of our organization suggests, we are concerned with the *effectiveness* of law enforcement in this country, within proper constitutional limitations. Because we believe that the provisions of S. 3814 and S. 3828 concerning governmental access to third-party records would deal a crippling, if not fatal, blow to the effectiveness of federal, state and local law enforcement in such areas as organized crime, international narcotics trafficking, white collar crime and various business frauds, we will address ourselves to these provisions.

The access provisions in Sections 4 and 5 of S. 3823 prohibit disclosure by a fiduciary institution of third-party records, under threat of civil and criminal penalties, unless such disclosure is made (1) with the consent of the customer or (2) pursuant to a court order based upon probable cause to support a search warrant to obtain financial records from the customer's own home and notice to the customer.

The access provisions of S. 3814 prohibit a financial institution from disclosing third-party records, under threat of civil and criminal penalties, unless (1) the account holder authorizes such disclosure [Section 4(a) and (b)]; (2) a subpoena has been issued with notice to the account holder [Section 4(c) and (d)]; or (3) a Fourth Amendment probable cause hearing, which presumably does not require notice to the account holder, has been held [Section 4(e)].

Considering the effect of the two bills together the following picture emerges:

ACCESS PROVISIONS

S. 3828	S. 3814
(1) authorization or consent of account holder	(1) authorization or consent of account holder
<i>or</i>	<i>or</i>
(2) notice to account holder and probable cause	(2) notice to account holder
	<i>or</i>
	(3) probable cause

The net effect is that no state or federal law enforcement agency could examine third-party records without the authorization *or* consent of the account holder, *or* probable cause.

Let us examine each of these three conditions for access to third-party records.

*1. Consent or authorization of the account holder*

It is sufficiently obvious so as not to require extended discussion that persons engaged in organized crime, white collar crime, frauds or narcotics trafficking are not going to consent to or authorize the examination of their records by law enforcement agencies which are seeking to prosecute them for such crimes. Thus the consent or authorization requirement would erect an impenetrable shield around such financial records.

*2. Notice to the account holder.*

Both bills provide procedures whereby law enforcement agencies may obtain third-party records upon a search warrant, subpoena, or court order *after notice* to the account holder. Insofar as the effect which notice would have on the effectiveness of law enforcement, this Subcommittee has, in the record, prepared statements and testimony on this point by the two persons most directly responsible for organized crime and international narcotics enforcement: The Honorable Eugene T. Rossides, Assistant Secretary of the Treasury for Enforcement, Tariff and Trade Affairs, and Operations; and The Honorable William S. Lynch, Chief, Organized Crime and Racketeering Section, Criminal Division, Department of Justice. Mr. Rossides, in his prepared statement before this Subcommittee on August 11, 1972 (hereinafter referred to as *The Rossides Statement*) summed

up succinctly the impact of notice requirements upon criminal investigations: "The provisions for notice to the subject are at best cumbersome if not totally impracticable. In numerous instances where bank records are sought, it is crucial that the subject of the investigation not be made aware of the matter under inquiry. The notice requirement would enable the suspect, in effect, to follow the progress of the investigation. As a result, the life of an informer or undercover agent may be jeopardized, records may be falsified or destroyed, funds may be concealed, and the subject may disappear." (*Rossides Statement, pages 20 and 21.*)

Mr. Lynch was no less emphatic regarding the deleterious effect of notice requirements. In his prepared statement before this Subcommittee on August 11, 1972 (hereinafter referred to as *The Lynch Statement*) he stated:

"I submit to The Subcommittee that, as [several previously noted] examples [of criminal cases] indicate, giving notice to an account holder that law enforcement officials desire to review his bank records will sabotage the ongoing criminal investigation. Since financial records are commonly an initial means of developing a criminal case, exposure of the Government's interest in bank records will allow a suspect to alter his operations, to falsify or destroy evidence, or even to flee the jurisdiction before an indictable case can be developed. This notice will serve as a red flag to the criminal that the authorities are on his trail." (*Lynch Statement, page 13.*)

We associate ourselves with and express our complete agreement with the two statements cited above; and, because of the overwhelming expertise of the gentlemen making these statements, we will not elaborate further upon the adverse impact of notice requirements for examination of financial records in criminal investigations.

As we have seen, then, consent or authorization of the subject and notice requirements would virtually stymie law enforcement in those crimes which require examination of third-party records. This leaves the third avenue of permissible examination under S. 3814 and S. 3828: a showing of probable cause.

### 3. Probable cause

Our system of criminal justice requires, quite properly, that law enforcement agents demonstrate to a neutral and detached magistrate probable cause to enter and search a private home, office, automobile or other premises upon which they believe criminal evidence is concealed. This is not the case however, with third-party records in the custody of financial institutions. As *The Lynch Statement* notes:

"The Supreme Court and all the circuits which have considered this issue have established that the customer of a financial institution has no proprietary interest in the records kept by the institution and that there are no constitutional inhibitions which prohibit reasonable inspections of financial records by the Government." (*Lynch Statement, page 15, citing cases and legislation to this effect.*)

In view of the fact that our courts and legislatures have set up no constitutional bars to the reasonable inspection of third-party records by government agencies, such records have long been utilized as invaluable *investigative leads* upon which the development of a criminal case, through the probable cause stage to eventual proof sufficient to indict and bring to trial. S. 3814 and S. 3828 would have the effect of raising the status of third-party records from that of investigative leads to that of probable cause which would support the search of a man's home.

There are several criticisms to be made of such an approach. The first lies in the distinction between those records which a person may wish to secrete in his home or office (thus requiring the Government to establish probable cause to seize them) and those records which the owner has seen fit to put into the basic stream of commerce through the drawing of checks, making of deposits, exchange transactions, etc. Organized and white collar criminals today make highly sophisticated use of financial transactions in order to further and conceal their efforts. To grant to such transactions the same status as records maintained in secret at homes and offices would permit such criminals to make the fullest use of commercial channels with near impunity from investigation by the Government.

Second, the "probable cause" approach of S. 3814 and S. 3828 is extremely unrealistic when viewed against the actualities of organized crime and similar investigations. Both Mr. Lynch (*Lynch Statement, page 17*) and Mr. Rossides (*Rossides Statement, page 21*) have stressed before this Subcommittee the fact

that third-party records are primarily utilized as investigative leads and that a probable cause requirement would effectively block criminal investigations. While I make no pretensions to the overall expertise of these two gentlemen I can confirm, based on six years experience in organized crime investigations as a Special Agent, Intelligence Division, Internal Revenue Service, that the use of third-party records in the *initial stages* of a criminal investigation is absolutely essential to the successful development and prosecution of such cases. Few law enforcement officers, federal, state, or local, enter into organized crime or white collar crime investigations with probable cause already present. Rather, the criminal has gone to elaborate precautions to conceal his activities; and thorough painstaking investigative techniques such as surveillance, infiltration of illicit operations, the use of informants, and examination of third-party records are necessitated in order to secure probable cause for an arrest or search. To remove the ability of law enforcement to utilize the examination of third-party records as an investigative tool would remove one of the most potent weapons in the Government's organized crime enforcement efforts.

Finally, the theory behind a probable cause requirement in cases of third-party records, could if taken to its logical conclusion, lead to a requirement for judicial approval before law enforcement officers could place a suspect under physical surveillance, contact an informant or infiltrate an undercover agent into an illicit operation. Such restraints would effect the demise of law enforcement against any type of secret crime, and this is a situation which this country can ill afford.

It requires no citation of authority to state that drug trafficking is a problem of major concern in our country today and that organized crime is a cancer and a corruptor in our society. While it is quite clear that law enforcement agencies must follow those restraints upon their investigative activities which courts and legislatures have established; it is equally clear, however, that such agencies would be seriously hampered by the creation of further restraints upon their activities *where such restraints do not exist and are not constitutionally mandated.*

Americans for Effective Law Enforcement, Inc. is grateful to this Subcommittee for the invitation to present its views and respectfully urges it to reject S. 3814 and S. 3828 *in toto.*

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