PUBLIC DOCUMENTS

OF THE

STATE OF MAINE

BEING THE

REPORTS

OF THE VARIOUS

PUBLIC OFFICERS DEPARTMENTS AND INSTITUTIONS

FOR THE TWO YEARS

JULY 1, 1930 - JUNE 30, 1932

STATE OF MAINE

REPORT

OF THE

Attorney General

for the calendar years

1931-1932

The "next general election" subsequent to September 14th is the election to be held in September, 1932. The option will be yours whether to set this general election as the date for a referendum election, or whether to call a special election at a date not less than four months nor more than six months after your proclamation determining the validity of the requested referendum.

TAXATION OF SAVINGS BANKS

November 21, 1932

To Hon. Frank H. Holley
State Tax Assessor

Regarding the tax returns of savings banks, the question is whether profits accruing from day to day during the six months' period are to be included in the "undivided profits" which form one element of the tax basis. My answer is in the affirmative. It seems to me that the statute, as worded, contemplates that at the close of business on each day the capital, surplus and entire profits accrued and undistributed up to the close of business on that day should be totalled and averaged with the corresponding figures for every other day during the period.

As a matter of law I base this on the ordinary meaning of the expression "undivided profits"; viz,—that it means profits that have not been divided.

Confirming my view, I find in the reports three cases under federal tax laws.

The earliest of these cases is *Leather, etc. Bank v. Treat*, 128 Fed. 262 (1904). This case held that a bank's accumulating profit and loss fund is taxable as "surplus" under a tax on capital and surplus. The case makes this ruling in the face of a concession in the case itself that in the nomenclature of banks the term "surplus" does not include "undivided profits."

The second case is *Harder v. Irwin*, 285 Fed. 452 (D. C. N. Y. 1923). This case holds that "undivided profits" include accumulations between the close of the preceding year and the date of distribution.

The leading case is *Edwards v. Douglass*, 269 U. S. 204 (1925). Here the Supreme Court of the United States discussed in great detail the meaning of the expression "undivided profits" under the federal income tax law. The point at issue was whether certain dividends were paid from profits of the current year or from profits of a previous year. The rate of taxation varied accordingly. The contention of the government that "undivided profits" includes the current earnings of the year was unheld by the court. The taxpayer claimed that the phrase "undivided profits" had a technical meaning; viz,—that earnings determined by computing inventories and balancing books at considerable intervals of time, approximately at the end of the fiscal year. One suggestion made by the court in a footnote is significant; viz,–that in modern accounting systems any corporation can ascertain its condition from its books almost from day to day, and certainly at exceedingly short intervals; it can determine its profits almost from day to day; it does not need to wait until the end of the year. The court says that the expression "undivided profits" does not have a definite, legal meaning as a bookkeeping term in corporation finance. The court rules that it does not necessarily mean an item on the corporation's books as distinguished from money earned but not distributed. In short, the court interprets the phrase as meaning "current undistributed earnings."

In view of these definite rulings by courts of exceedingly high authority, I can have no doubt as to the legal interpretation of the phrase as we find it in the statute under interpretation. For tax purposes the bank should compute its undivided profits from day to day and include them in the taxable basis.

I understand from talking with the treasurer of the savings bank which has raised the point that while he concedes that from the books of the bank it is possible to determine this item from day to day, yet for two reasons he doubts the application of the tax to these profits.

The first of these reasons is that "undivided profits" means the bookkeeping item set up by the bank at the beginning of the period and left untouched until the end of the period except for charging against it the whole or any part of any dividend as may be declared.

My answer to this suggestion is the citation of the three cases above mentioned. To adopt the treasurer's theory would not only be contrary to these three cases, but would also permit the bank, by bookkeeping notations to affect its tax payment.

His second suggestion is that the tax should be a tax on capital and not on current income. My answer is that this is a consideration which might appeal to the legislature in imposing or modifying the tax. We have to take the law, however, as we find it. It was proper for the legislature to fix such rate as it thought best and place it on such basis as it thought best as a means of valuing the franchise. The legislature did choose a basis made up of three items and a tax at one-half of one percent. Of course it may in the future change the basis, or change the rate.

As it stands, I can see no other alternative but to adhere to my interpretation of the statute as it stands.