PROPOSALS

FOR

REVISION OF THE TAX STRUCTURE

OF THE

COMMONWEALTH OF PENNSYLVANIA

A Report

to the

COMMITTEE ON CONTINUATION
OF THE TAX STUDY

OF THE

JOINT STATE GOVERNMENT COMMISSION
(OF THE GENERAL ASSEMBLY)

BY

THE TAX ADVISORY COMMITTEE

REPORT NO. 11
JANUARY 15, 1945

CAPITOL BUILDING
HARRISBURG, PA.

JOINT STATE GOVERNMENT COMMISSION
OF
THE GENERAL ASSEMBLY

(Created in 1937, P. L. 2460, as last amended 1943, P. L. 13)

"A continuing agency of the General Assembly to undertake studies and develop facts, information and data on all phases of government for the use of the General Assembly and Departments and Agencies of the State Government."

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LETTER OF TRANSMITTAL

To the Members of the Joint State Government Commission of the General Assembly of Pennsylvania:

Under authority of the Act of July 1, 1937, P. L. 2460 (Act creating Joint State Government Commission), as last amended by the Act of March 8, 1943, P. L. 13, we submit herewith a report of the Tax Advisory Committee containing Proposals for the Revision of the Tax Structure of the Commonwealth of Pennsylvania.

LLOYD H. WOOD, *Chairman,*
Committee on Continuation of the Tax Study.

January 15, 1945.

FOREWORD

During 1943 and 1944 the Committee on Continuation of the Tax Study, a sub-committee of the Joint State Government Commission, submitted to the Joint State Government Commission and to the General Assembly of the Commonwealth ten major reports. All these reports were the outgrowth of studies, made during these years by the Committee on Continuation of the Tax Study, of the overall tax structure and economic resources of the Commonwealth and its political subdivisions, as background data, essential to the General Assembly in any consideration, which it may see fit to give to the vital problems of revision of the tax structure of the Commonwealth.

These ten reports, all of which have been published from time to time, as official reports of the Joint State Government Commission, are:

No. 1—The Debt of the Commonwealth of Pennsylvania and its Local Subdivisions.

No. 2.—Fiscal Operations and Debt of the School District of Philadelphia, 1920-1943.

No. 3—Fiscal Operations and Debt of the School District of Pittsburgh, 1919-1943.

No. 4—Fiscal Operations and Debt of the School District of Scranton, 1919-1943.

No. 5—Fiscal Operations and Debts of Eleven Selected School Districts, 1920-1943.

No. 6—An Analysis of the Fiscal Operations of the School Districts of the Commonwealth of Pennsylvania, 1920-1942 (with Appendix).

No. 7—An Analysis of Public Expenditures for Education in the Commonwealth of Pennsylvania.

No. 8—The Structure and Revenues of the General Fund of the Commonwealth of Pennsylvania, 1913-1943.

No. 9—Fiscal Analysis of the Operating Funds of the Commonwealth of Pennsylvania, 1923-1943.

No. 10—The Economic Resources and Related Tax Problems of the Commonwealth of Pennsylvania.

The attached document, a report of the so-called Tax Advisory Committee, which is a Citizens' Committee, composed of outstanding tax experts of the Commonwealth, represents the unanimous views of these experts with reference to the existing inequities and discriminations, the present inequitable burden of taxation on certain of the tax resources of the Commonwealth and its political subdivisions, the existing unfair allocation of the costs of various governmental functions among the Commonwealth and its political subdivisions, the incidence, productivity, and degree of stability of specific taxes of the Commonwealth, and, finally, the considered judgment of that Committee as to the best means by which these various defects in the current tax structure can be corrected so as to give the Commonwealth the best conceivable tax structure and thereby encourage maximum production, employment, and high standards of living for the citizens of the Commonwealth in the postwar years.

The recommendations of the Tax Advisory Committee have been resolved by that Committee as an independent citizens' committee, responsible to no one, but themselves. They have been submitted to the Committee on Continuation of the Tax Study of the Joint State Government Commission to assist it and the General Assembly of the Commonwealth in their studies of the reorganization of the Commonwealth's tax structure and the solution of the related problems, now facing the Commonwealth.

The Committee on Continuation of the Tax Study, after a careful review of the report of the Tax Advisory Committee, voted by formal resolution that the report should be printed for submission to the Joint State Government Commission and to the General Assembly, in the hope that the recommendations, contained therein, may be given full consideration by the Commission and the General Assembly and that such publication, followed by widespread public discussion of the problems, involved in the reorganization of the tax structure, as well as the constructive recommendations of the Advisory Committee, will be effective in focusing the attention of the General Assembly and the citizens of the Commonwealth on the vital issues of tax revision and fiscal policies of the Commonwealth and its political subdivisions.

However, it should be clearly understood that, in taking this action, neither the Committee on Continuation of the Tax Study nor the Joint State Government Commission have either approved or disapproved of the specific conclusions and recommendations, contained in the report of the Tax Advisory Committee. The report, however, is a major and invaluable contribution to the work of the Joint State Government Commission and its subcommittee in their studies of the fiscal problems of the Commonwealth. The recommendations of the Tax Advisory Committee, as well as the factual data developed by that Committee, must be given sober and careful consideration. The Committee on Continuation of the Tax Study and the Joint State Government Commission are greatly indebted to the Chairman and members of the Tax Advisory Committee for this valuable assistance in the solution of these serious problems, now confronting the Commonwealth.

The report of the Tax Advisory Committee is divided into four parts. Part I is a summary of the present tax structure, the proposed tax plan, recommendations for reallocation of certain governmental functions among the Commonwealth and its political subdivisions, and the revenue and other effects of these combined proposals. Part II is a detailed and historical analysis of all specific taxes, now imposed by the Commonwealth and its political subdivisions, with specific and detailed recommendations for extension of certain of these taxes (to groups now not covered by them), the repeal of other taxes, the shifting of the yields of still other taxes from the Commonwealth to the local units of government, possible new sources of revenue, and, finally, proposals for improvement in state and local tax administration. This part also contains a review of the tax yields of individual taxes of the Commonwealth and its political subdivisons over the past decade or more. Part III contains an analysis of the present allocation of governmental functions among the Commonwealth and its political subdivisions, together with specific recommendations for reallocation of certain of these functions and their respective costs. Part IV is a projection into the postwar years of the revenues of the General Fund of the Commonwealth, estimated at various potential levels of state and national income.

The Joint State Government Commission and its Committee on Continuation of the Tax Study are necessarily concerned with the total tax burdens on the citizens, business, and industry in the Commonwealth, the development of a tax structure to encourage maximum production, employment, and constantly rising standards of living, as well as a proper distribution of governmental functions and their respective costs among the Commonwealth and its political subdivisions.

The problems of local revenues are the concern of the Local Government Commission (of the General Assembly) which was created in 1935 "to study and report all functions of local government; their allocation and elimination; the cost of local government and means of reducing it; and the consolidation of local government." Consequently, this report of the Tax Advisory Committee necessarily relates to the spheres of inquiries of both the Joint State Government Commission and the Local Government Commission. Therefore, the publication of this report and widespread public discussion of the problems posed therein, as well as the recommendations, made for the solution of these problems, will be of great assistance to both Commissions of the General Assembly.

The Joint State Government Commission and its Committee on Continuation of the Tax Study wish to express their appreciation to the Chairman and members of the Tax Advisory Committee, as well as to the 200 or more citizens and to the many public officials of the Commonwealth, who assisted that Committee in the development of this report and, in the course of its studies, gave unsparingly of their time and experienced counsel. The Commission and its Committee likewise are greatly indebted to the research staffs of the Pennsylvania State Chamber of Commerce and the Pennsylvania Economy League, who gave valuable technical assistance in the development of the voluminous statistical, historical, and economic research data, necessary in the development of the report of the Tax Advisory Committee.

Finally, the Commission and its Committee on Continuation of the Tax Study again express their sincere appreciation to the Pennsylvania Economy League for similar assistance in the development, throughout the past two years, of the ten reports, all of which were essential background material in connection with the studies of the Committee throughout the biennium.

IRA T. FISS, *Chairman,*
Joint State Government Commission;

LLOYD H. WOOD, *Chairman,*
Committee on Continuation of the Tax Study;

HOMER S. BROWN,
FRANKLIN SPENCER EDMONDS,
JAMES A. GELTZ,
WELDON B. HEYBURN,
BERNARD B. MCGINNIS,
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EDWIN WINNER (Advisory).

A. ALFRED WASSERMAN, *Counsel.*

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LETTER OF SUBMITTAL

JANUARY 10, 1945.

HON. LLOYD H. WOOD, *Chairman,*
Committee on Continuation of the Tax Study
Joint State Government Commission,
Commonwealth of Pennsylvania,
State Capitol,
Harrisburg, Pennsylvania.

Dear Mr. Wood:

As Chairman of the Tax Advisory Committee, it gives me great satisfaction and pleasure to present to you herewith that Committee's report and recommendations on the reorganization of the tax structure of the Commonwealth of Pennsylvania and its political subdivisions.

More than a year ago the Tax Advisory Committee was organized as a Citizens' Committee, through the auspices of the Pennsylvania Economy League and the Pennsylvania State Chamber of Commerce, to lend all possible assistance to your Committee on Continuation of the Tax Study in the completion of its assignment from the Joint State Government Commission and the General Assembly to produce and recommend a more equitable and efficient tax structure for the Commonwealth. Shortly after its organization, as you will recall, the Tax Advisory Committee, composed of fifteen of the outstanding tax experts of the Commonwealth, was accepted by the Committee on Continuation of the Tax Study as a citizens' advisory tax committee to furnish tax data and assist in its study.

Consequently, the Tax Advisory Committee, acting as an independent, non-political, and non-partisan citizens' committee, has attempted to perform the task assigned to it, free of all bias or prejudice, and to produce such a report and recommendations as would give the maximum benefit to the Commonwealth, its political subdivisions, and its citizens. The report has been prepared and all recommendations resolved on this basis, without interference or control by any organization or group within the state. It constitutes the best objective and independent judgment of the members of the Tax Advisory Committee and of the various subcommittees, associated with it in the undertaking.

The task of the Committee was of such magnitude that it was deemed necessary to call upon more than 200 individuals, experienced in the problems of taxation and fiscal policy, to assist the Advisory Committee in its efforts. These individuals included specialists in various fields of taxation, businessmen, present and former administrative officials of the various departments of the Commonwealth, many from the legal and accounting professions, as well as the technical research staffs of the Pennsylvania Economy League and the Pennsylvania State Chamber of Commerce.

The Tax Advisory Committee is deeply indebted for the aid received from these individuals, without whose help the work of the Committee would not have been possible. However, the Tax Advisory Committee assumed, and must continue to assume, full responsibility for all final conclusions and recommendations as to matters of policy, as well as for any errors, that may appear in the report.

The work of the Committee was so organized that each field of taxation was initially studied by a subcommittee, headed by a member of the Tax Advisory Committee, and all subcommittee reports were reviewed by a co-ordinating group, so that the final recommendations of the Committee would reflect the considered judgment, not only of the subcommittees, but also of the Tax Advisory Committee as a whole, and thus assure unselfish and disinterested, as well as non-political, points of view. It is of special satisfaction to me that there was no minority report by any member of the Committee.

It will, of course, be the responsibility of your Committee and the Joint State Government Commission to appraise the value of the report and make such use of its recommendations as your Commission may see fit.

The members of the Tax Advisory Committee desire no credit for themselves and no publicity whatsoever has been sought or connected with their activities in the development of the report. However, we do not look upon the result of our labors as "just another report". We strongly feel that the efforts of this large citizens' committee deserve the most careful consideration of every member of your Committee, the Joint State Government Commission, and the General Assembly.

The war has brought into being a new and fast-changing world, hich will surely leave our country and the Commonwealth with problems of unprecedented complications and seriousness. To meet and solve these problems will require the combined genius and thinking of the best minds available to the Commonwealth, regardless of political affiliations. All classes of citizens, management, labor, and agriculture must co-operate and render such assistance as they can, according to their ability, and all other groups, who have the best interests of the people of the Commonwealth at heart, must likewise participate in the solution of these problems, underlying which is the problem of taxation and revenues for the Commonwealth and its political subdivisions.

Fundamentally, there can be only one objective for all of us, namely, the expansion of production of our mines, forests, farms, and factories far beyond anything yet known in peace time and to encourage home ownership among our workers. This, in turn, must assure employment for everyone, at wage standards of the highest possible level, which the economy of the Commonwealth can afford, so that consumer purchasing power will not only be fully maintained after conversion and in the postwar years, but will continue to rise to assure higher standards of living for all our citizens so as to make Pennsylvania a more desirable place in which to live and work. If this aim is to be accomplished, there must be no retarding influence from the imposition of excessive or inequitable taxes, federal, state, or local.

The Committee has tried in every way in its power to achieve a better distribution of the tax burden among all elements in the Commonwealth and enable Pennsylvania to maintain its historical position among the industrial states of the nation and to place it in the best possible position to foster and assure expansion in the Commonwealth of production and employment in all fields of activity in the postwar years.

The war has already invaded the homes of many of our citizens with tragic results. These experiences tend to make us better appreciate our grave responsibilities to those who have made such valiant sacrifices on the fields of battle. They have also strongly influenced us in our desire to achieve an objective, as well as a realistic, approach in our effort to find the solution to our postwar problems. I am sure that these considerations are reflected by the unselfish and patriotic

CHAPTER 1

ECONOMIC BACKGROUND AND CURRENT TRENDS

Sober consideration of current trends, now evident in the various economic factors, which underlie the present tax structure of the Commonwealth, emphasizes the importance of enabling and encouraging industry and business enterprise to reverse various unfavorable trends, which have been apparent for many years. Over the past twenty years there has been a steady decline in the proportion of national population, national wealth, and national income, enjoyed by the Commonwealth of Pennsylvania. These alarming developments are related in some major degree to an *absolute* decline in the production of the Commonwealth's extractive industries, as well as to a relative decline in the Commonwealth's share of national production, derived from the heavy industries and, to a less extent, from the processing and finishing industries. The current industrial boom, beginning in 1941, which has resulted from prosecution of the current war, has actually accelerated the former trends, despite a great expansion in production and employment in most all fields of activity within the state. Present trends indicate, however, that, with the conclusion of the war production phase, the decline of the Commonwealth's share of the national wealth and national income will be even greater than in the past decade, unless, among other factors, the tax policy of the Commonwealth is revised in such a constructive manner as to attract to the state new capital for expansion of existing industries, as well as for creation of new enterprises.

Eight major industrial states of the Union have been selected for comparison of various trends in their economy with those of Pennsylvania. These states are Massachusetts, New York, and New Jersey, which like Pennsylvania, are old line industrial states, the highly industrial states of Ohio, Michigan, Illinois, and Indiana in the mid-west, and California on the Pacific Coast.

Population Growth—1910-1943

Since 1910 the rate of increase in Pennsylvania's population has steadily been falling behind that of the nation. In the decade, 1900-1910, the population of Pennsylvania increased 21.6 percent and the national population, 21.0 percent. In 1910 the Commonwealth's population amounted to 8.3 percent of the national total. In the following decades Pennsylvania's rate of population increase steadily dropped below that of the nation. In fact, in the 1930-1940 decade the Commonwealth's rate of increase was only 2.8 percent, compared with 7.2 percent for the nation as a whole. By 1940 Pennsylvania's population had dropped from 8.3 percent in 1910 to 7.5 percent of the national total. In 1940 only three of the eight comparable states of the Union showed a decrease in their respective shares of the national population, compared with their shares in 1910. These were Massachusetts, with a decline from 3.7 percent to 3.3 percent; Illinois, 6.1 percent to 6.0 percent; and Indiana, with a decline from 2.9 percent to 2.7 percent of the total population. Changes in the percentage of total population for the remaining five states ranged from no change, in Ohio, to an increase, in the case of California, from 2.6 percent in 1910 to 5.2 percent of the total population in 1940.

State and National Income Payments[1]—1919-1943

Pennsylvania's income payments, or total income received by individual residents of Pennsylvania, amounted to $5.5 billion or 8.6 percent of total national income payments of $63.0 billion in 1919. In the decade, 1919-1929, aggregate national income payments increased by 31.1 percent to $82.6 billion, while Pennsylvania's income payments showed a greater than average increase, 34.6 percent, and rose to 8.9 percent of total national income payments. At the end of the following decade, however, Pennsylvania's income payments had decreased by 20.7 percent in 1939, compared with a rate of decrease for all states of only 14.6 percent, and Pennsylvania's share of the national total in 1939 had fallen to 8.2 percent of the total. In 1943, with total national income payments rising to a historic peak of $138.1 billion, Pennsylvania's share rose to $9.9 billion, but represented only 7.2 percent of the total. The percentage increase in the state's income payments from 1939 through 1943 amounted to only 70.5 percent, compared with an increase of 95.6 percent in national income payments in the same period. In short, the Commonwealth's share of national income pay-

[1] Reference throughout this section is to total national income payments, by states, excluding payments, made to individuals abroad, etc., which cannot be allocated by states.

ments fell from 8.6 percent of the total in 1919 to 7.2 percent in 1943. The decline in Pennsylvania was again greater than that shown by any of the other eight states.

Value of Manufacturing Product—1909-1939

The Commonwealth's share of the total value of the manufacturing product of the nation declined from 12.7 percent in 1909 to 9.6 percent in 1939. The following table presents the proportionate shares of the value of total manufacturing product for Pennsylvania and eight selected states at ten-year intervals from 1909 to 1939:

PERCENTAGE DISTRIBUTION OF TOTAL VALUE OF MANUFACTURING PRODUCT—BY SELECTED STATES

	1909	*1919*	*1929*	*1939*	*Degree of Change 1939 from 1909*
Value of National Manufacturing Product (in billions)	$19.9	$60.0	$68.0	$56.8	....
Percentage Distribution					
United States	100.0	100.0	100.0	100.0	....
Pennsylvania	12.7	11.8	10.6	9.6	— 24.4
Massachusetts	7.2	6.5	4.8	4.3	— 40.3
New York	16.3	14.4	14.1	12.6	— 22.7
Illinois	9.3	8.8	8.9	8.4	— 9.7
New Jersey	5.5	5.9	3.0	6.0	+ 10.9
Ohio	7.0	8.3	8.6	8.1	+ 11.6
Michigan	3.3	5.6	6.6	7.6	+130.3
Indiana	2.8	3.1	3.6	3.9	+ 39.3
California	2.6	3.2	4.4	4.9	+ 88.5

Source: Statistical Abstracts and Reports of Biennial Census of Manufacturing, U. S. Department of Commerce.

The above table shows an unbroken trend of decreasing shares of total value of the nation's manufacturing product between 1909 and 1939 for Pennsylvania, Massachusetts, and New York, while the downward trend was irregular for Illinois. Three states—Michigan, Indiana, and California—showed a consistent growth in their shares and, while the trends were irregular, New Jersey and Ohio secured a larger share of total manufacturing product in 1939 than they had in 1909.

Over the thirty-year period the value of the nation's manufacturing product rose from $19.9 billion in 1909 to $68.0 billion in 1929, and fell to $56.8 billion in 1939, a proportionate increase of 242 percent between 1909 and 1929, followed by a decrease of 16.5 percent in 1939. Pennsylvania's share of the total manufacturing product rose from $2.6 billion in 1909 to $7.4 billion in 1929, and fell to $5.5 billion, an increase of 182 percent and a decrease of 26.2 percent, respectively. These comparative rates of increase and decrease for the nation and for the Commonwealth tell in broad terms the alarming story of the relative decline in the value of the Commonwealth's manufacturing.

Extractive Industry—1910-1940

The value of mining product in the Commonwealth, as a percentage of total national mining product, has declined steadily by ten-year intervals from 29.8 percent in 1910 to 11 percent in 1940. There has also been an absolute decline in the value of Pennsylvania's mining product, which in 1942 was only 63.8 percent of that of 1920 and 96.5 percent of 1917, a comparable war year.

For many years Pennsylvania's extractive industry was foremost in the nation. In recent years, however, the Commonwealth has been surpassed by Texas, which has shown a tremendous expansion in oil production. During World War I Pennsylvania produced about 18 percent of the nation's minerals, but by 1938 the Commonwealth's share had fallen to 12 percent of the total production.

Bituminous coal, which accounts for nearly two-thirds of the Commonwealth's coal production, has shown a tremendous absolute decline since peak production of 178.6 million tons in 1918. In 1932 production had dropped as low as 74.8 million tons, a decline of 58.1 percent, and in 1939 it amounted to only 92.2 million tons, or 48.4 percent less than in 1918. During the decade 1920-1929 the Commonwealth's total bituminous coal production was 1.4 *billion* tons, in the following decade (1930-1939) total production amounted to only 948 *million* tons, a decrease of 32.3 percent in the second decade.

The bituminous coal industry, as a whole, has fallen behind the rate of national industrial production. In 1923 the index numbers (1923-1925=100) of industrial production and bituminous coal production were 101 and 108, respectively. In 1939 the industrial production index had advanced slightly to 106, but that for bituminous coal production had fallen to 75. Meanwhile, the Commonwealth's share of national bituminous coal production declined steadily from 35.0 percent of the national bituminous coal production in 1914 and 1915 to 23.4 percent in 1939.

Not only has Pennsylvania suffered a loss in its proportionate share of national bituminous coal production, but it was replaced, as the prime producer of bituminous coal, by West Virginia as early as 1931. In 1939 West Virginia's bituminous coal production was 27.5 percent of the national total, compared with 23.4 percent for the Commonwealth. In 1938 the Commonwealth's proportionate share of national bituminous coal production had dropped from a high of 35.7 percent in 1915 to an all time low of 22.3 percent of the national bituminous coal production.

Anthracite, which accounts for more than one-third of the Commonwealth's total coal production, has also shown a great decline since the period of World War I. In 1914 production amounted to 90.8 million tons. After reaching a peak of 99.6 million tons in 1917, it declined irregularly, but steadily, to a low of 46.1 million tons in 1938. In 1939 anthracite production amounted to 51.5 million tons, a decrease of 43.3 percent from 1914 production.

Production of crude petroleum in the Commonwealth, despite an increase from 8.2 million barrels in 1914 to 17.4 million barrels in 1940, showed a proportionate decrease, when related to national production, from 3.1 percent to 1.3 percent in the same years. During the early thirties the Commonwealth's share of oil production improved from 1.0 percent in 1923 and 1924 to 1.6 percent of national production in 1934-1936, inclusive, before a new trend of decline developed.

The following table presents comparative data on the trends of the value of mining products for the United States and for Pennsylvania:

VALUE OF MINING PRODUCT

(in thousands of dollars)

Year	*United States*	*Ratio 1910=100*	*Pennsylvania*	*Ratio 1910=100*	*Percent Pennsylvania of United States*
1910	1,987,844	100	591,603	100	29.8
1920	6,981,340	351	1,314,333	222	18.8
1930	4,764,800	240	778,523	132	16.3
1940	5,614,800	282	618,348	105	11.0

Source: Mineral Resources of the United States, U. S. Geological Survey, Department of Interior.

Despite the relative decline in its extractive industries, Pennsylvania is still a leading extractive state with a higher percentage of its workers, employed in mining in 1940, than in other states, with the exception of Nevada, Wyoming, Montana, Arizona, West Virginia, and Kentucky, none of which is of comparable industrial importance. Nevertheless, the absolute decline in coal production and the relative decline in Pennsylvania's share of the nation's extractive industry make it imperative that the Commonwealth take steps to induce new industries to enter its depleted areas and convert these districts to new diversified industrial activities.

The decrease of extractive production in certain areas of the Commonwealth is illustrated by the rise and fall in the value of anthracite, mined in Lackawanna County. Over a period of fifteen years from 1910 to 1925, the value of this product rose from $37.7 million to $109.8 million, an increase of 191 percent. In the succeeding fifteen years, the value of anthracite, mined in Lackawanna County, fell to $30.9 million in 1940, 18 percent less than the value of the county's anthracite production in 1910.[1]

Into the considerations of a more desirable postwar tax structure, Pennsylvania's position, as a highly extractive state, introduces a basic economic factor, which does not exist in the same degree in any other highly industrialized state. If taxation by the Commonwealth and its political subdivisions is to be sound, equitable, and fitted especially to the underlying economic resources of Pennsylvania, the state must be willing to assume a tax structure, quite radically different from that of other states, in which different economic factors may favor the development of other forms of taxation.

PRESENT TAX STRUCTURE OF THE COMMONWEALTH

The present normal tax structure of the state dates from a period, when the population, income, wealth, and industries of the state were

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[1] Value of anthracite, mined in Lackawanna County, Pennsylvania [(a)]

	Amount (in thousands of dollars)	*Index* (1910 = 100)
1910	$37,715	100
1920	98,010	260
1925	109,800	291
1930	79,716	211
1940	30,921	82

(a) Pennsylvania Department of Internal Affairs.

expanding at a greater rate than for the nation as a whole, and, when the heavy industries of the state clearly dominated their respective national fields. Although this condition has not prevailed for more than a quarter of a century, the state, until 1935, continued to tighten up the old tax structure rather than to revise its fundamental tax policy in such a manner as to encourage the confidence and incentive, necessary for renewed growth in business and industry within the state, particularly, to replace the loss in the extractive industries.

From 1935 to 1943 the state's revenue needs resulted in changes in the tax structure, which uncovered certain new sources of tax revenues, but also added even heavier taxes upon manufacturing capital, employed within the state, as well as upon other business corporations, public utilities, banks, and trust companies. At this time, when tax revision is again under discussion, the unfavorable economic trends, which have developed so strongly since 1919 and appear likely to be even more pronounced in the postwar era, should be made a major consideration in determining the substance of the new tax structure. The Commonwealth's tax policy should safeguard the general welfare of Pennsylvania by stimulating industrial and business enterprise and full employment so that the adverse economic trends, at work in the state since 1919, may be reversed. Furthermore, new private enterprises must be induced to enter the areas of depleted resources to convert these districts to diversified industrial activities. Unthrifty taxation of declining income and resources, however, will only serve to hasten the process of unfavorable decline, now so evident throughout the Commonwealth's economy.

Comparison of Tax Structures in Pennsylvania and Other States

A review of the tax structures of Pennsylvania and the eight other large industrial states of the Nation presents many sharp contrasts. Geographically, none of the four Atlantic Coast industrial states, including Pennsylvania, presently levy a tax upon general sales, use, or gross income, while such taxes are favored in the four industrial midwestern states and California. On the other hand, none of the midwestern states or New Jersey presently levies taxes on corporate net income or individual net income, while Massachusetts, New York, and California levy taxes on both forms of net income and Pennsylvania taxes only corporate net income.

The proportion of total tax revenues of these industrial states, derived from taxes on corporate net income, corporations in general, and specific business, together with the proportion of total tax receipts, derived from taxes on individual net income, general sales, use, or gross income, and selected sales, are shown in the following summary table:

PERCENT OF TOTAL TAX REVENUES DERIVED FROM SELECTED BASES—1941

(Nine industrial states)

State	*Corporate Net Income*	*Specific Businesses*[1]	*Total*	*Individual Net Income*	*General Sales, Gross Income*	*Selected Sales*	*Total*
Pennsylvania	11.2	23.9	35.1	....	....	35.6	35.6
New York	11.9	15.3	27.2	23.7	....	28.1	51.8
Massachusetts	4.8	19.7	24.5	17.0	....	31.6	48.6
California	8.0	8.1	16.1	7.1	38.5	22.9	68.5
Ohio	....	13.0	13.0	....	28.3	40.2	68.5
Illinois	....	10.2	10.2	....	48.7	29.2	77.9
Michigan	....	8.4	8.4	....	42.7	22.6	65.3
New Jersey	....	8.1	8.1	....	....	35.6	35.6
Indiana	....	7.0	7.0	....	30.1	37.4	67.5

[1] Includes corporations in general.

Pennsylvania's heavy tax burden, both relative and comparative, on corporate net income and specific businesses (including taxes on corporations in general and capital stock taxes) is at once apparent from the above table. None of the comparable states approaches the Commonwealth's proportion of 35.1 percent of total tax revenues, derived from these sources. For the other states, the proportion of these taxes to total tax revenues varies from 7.0 percent in Indiana to 27.2 percent in New York.

On the other hand, Pennsylvania and New Jersey show the smallest proportionate collections from taxes on individual net income, general sales, use, and gross income, and selected sales, amounting to 35.6 percent. The other seven states received from these bases tax revenues, ranging from 48.6 percent in Massachusetts to 77.9 percent in Illinois.

In general, those states with a tax on general sales or gross income, but no tax on individual net income, have the smallest proportion of total tax collections from taxes on specific business and corporate net income. In turn, the states with an individual net income tax, but no general sales or gross income tax have a smaller proportion of total tax collections from taxes on specific businesses and corporate net income than does Pennsylvania, which taxes neither general sales nor gross income nor individual net income.

Local Tax Indices

The indices of state tax loads, based on the relation of tax revenues to state income payments, for the eight states and Pennsylvania show much less deviation than those for local government. In 1941 the state tax load index for all forty-eight states was 108.7 compared with a base of 100 for Pennsylvania. The eight selected states had an index of 101.3, which indicates a surprising uniformity in the total tax burden, levied by these state governments upon their various tax sources, when related to state income.

At the local level of government, however, the index of local tax load for the forty-eight states soared to 163.2, compared with Pennsylvania's basic index of 100. The local tax load index for the eight comparable states was 115.1, still substantially above that of Pennsylvania. In other words, it appears that, in comparison with the eight competitive states, Pennsylvania imposes a tax burden, which, when related to state income, was only slightly lower at the state level, but decidedly lower at the local level of government than in other states. The combined tax loads for state and local governments, related to state income, stands in favor of Pennsylvania with an index of 100, compared with 111.5 for the eight comparable states and with 139.6 for the forty-eight states.

Distribution of Overall Tax Load

These data, however, do not take into consideration the distribution of the tax load among the various taxable resources of the various states. As has been pointed out earlier, the distribution of Pennsylvania's tax burden shows striking differences from those of its competitors in that the Commonwealth's tax revenues are derived more from taxation of capital and corporate net income than in the comparable states in the east, which utilize individual incomes taxes, and in the mid-western states and California, which emphasize taxes on general sales, use, or gross income, as revenue producers. None of these taxes is employed by the Commonwealth at the state level. The comparative 1941 data on tax loads, related to state income, indicate that the overall tax load of Pennsylvania is not excessive in view of the average of its industrial competitors, but that vital differences exist in the inequitable distribution of the tax load over the state's tax resources.

Pennsylvania employs a corporate net income tax, but does not utilize taxes on either individual net income or general sales. The competitive states in the east, with the exception of New Jersey, have utilized individual net income taxes, and, in the case of Massachusetts, a general tax on real property. The mid-western states (Ohio, Michigan, Illinois, and Indiana) have made use of both a general sales or gross income tax and taxes on selected commodities (with the exception of tobacco products in all these states, but Ohio), but have avoided the individual net income tax, employed in New York and Massachusetts. California, on the other hand, levies state taxes on corporate and individual net income and general sales. The yields of these taxes, as well as the rates of taxation of motor vehicles and operators, specific businesses, and personal property, however, appear to be decidedly below those of the other states in the competitive group. *Pennsylvania, therefore, is the only state,* not excepting New Jersey (which levies a heavy general property tax and exceptionally heavy taxes upon motor vehicles and operators), which extracts so large a proportion of its state tax revenues from taxes on capital and corporate net income.

This fact, in view of the fundamental desirability of encouraging industry to come into the state, as the principal means of producing and maintaining a high level of state income and, consequently, employment and consumption, indicates that the tax policy of the Commonwealth must be promptly revised. It must be reorganized not only to provide the revenue, essential for desirable state and local governmental functions, but to distribute the tax burden over its taxable resources in such a manner that private enterprise (in industry and business) will be given positive encouragement to enter and expand in the state in order to reverse present trends in the state's economy, particularly in the distressed and depleted areas. This result can be accomplished by a reapportionment of the tax burden, which will permit the Commonwealth to offer to private enterprise approximate equality with competitive states in the tax burden on capital and corporate net income.[1]

[1] For a complete discussion of the current economic trends in Pennsylvania, and the comparative tax burdens of other states, briefly considered in this chapter, see Report Number 10 of the Joint State Government Commission, entitled "The Economic Resources and Related Tax Problems of the Commonwealth", published January 20, 1945.

CHAPTER 2

SUMMARY OF THE PROPOSED TAX PLAN OF THE TAX ADVISORY COMMITTEE[1]

The major recommendations affecting the state's principal revenue-producing taxes are summarized in this chapter. Many of these recommendations are interrelated with those concerning the reallocation of governmental functions, summarized in Chapter 3, of this Part.

CORPORATE NET INCOME TAX

The emergency corporate net income tax should be made a permanent part of the state's system of taxing business corporations. While the current rate of the corporate net income tax exceeds that, imposed by most other states, this tax is more responsive to economic changes and less burdensome in periods of depression than is the capital stock-franchise tax. Therefore, relief from the capital stock-franchise tax deserves priority over any scaling down of the corporate net income tax. However, the latter should not be overlooked, primarily because the 1943 revision of the corporate net income tax materially increased the tax burden on many corporations. Furthermore, it is the combination of the levies on capital stock and on corporate net income, which imposes the present heavier tax burden upon corporate enterprises in Pennsylvania than is found in most competing industrial states.

The elimination in 1943 by the General Assembly of the previously allowed deduction for federal income and excess profits taxes brought the yield of the state's corporate net income tax in more direct relationship to state and national income. This action had the advantage of enhancing the predictability of the tax, because variations in the burden of federal income and excess profits taxes have been extreme in recent years. However, that action incidentally eliminated the deduction for federal Declared Value Excess Profits Tax, which is a penalty tax, applicable only under certain conditions. This federal tax is even deductible in calculating other federal taxes and it should be deductible under the Pennsylvania act.

As the Corporate Net Income Tax Act is presently administered, the state taxing departments do not recognize a change in net income,

[1] See Part II of this report for the complete Tax Plan of the Tax Advisory Committee.

due to renegotiation of war contracts, until the corporation's income tax return for the year in question has been finally audited by the Bureau of Internal Revenue. A change in net income, due to the refund of excessive profits, resulting from renegotiation of war contracts, should be designated by the act as a change, made by an agency of the federal government and, when filed with the Commonwealth, should be recognized as a basis for adjustment of the corporation's taxable income.

The act should be further amended to permit the filing of consolidated reports by affiliated companies, where such filing is permitted for federal tax purposes. If desirable from an administrative standpoint, there would seem to be no objection to the making of an application for the filing of a consolidated report, but the right to file such a report should be discretionary with the taxpayer and not the state.

While the first fraction of the general apportionment formula, by which the net income of corporations, doing business within and without the state, is apportioned to Pennsylvania, presents little difficulty, the second and third fractions are so phrased as to work undue hardship in the case of certain corporations. This is because these fractions, insofar as the assignment of wages and gross receipts to Pennsylvania are concerned, are stated in the negative. The natural presumption that the business of a foreign corporation is done primarily outside of the state is thus arbitrarily reversed. The fractions would be more equitable, if wages were assigned to Pennsylvania according to where the employes chiefly do their work, and gross receipts were assigned according to the geographical source of the business. In stating this fraction affirmatively, however, care should be taken, on the one hand, to leave room for reasonable interpretation and, on the other, to prevent avoidance of tax.

A similar change should be made in the apportionment formula of the franchise tax.

Consequently, the Tax Advisory Committee recommends:

1. That the corporate net income tax be made a permanent state tax.
2. That a deduction be allowed for the federal declared value excess profits tax.
3. That a change in net income, resulting from the refund of excessive profits after renegotiation of war contracts, should be

designated in the state act as a change, made by an agency of the federal government, and that a report of change, giving effect thereto, be filed with the Commonwealth.

4. That an affiliated group of corporations, doing business in Pennsylvania, be given the right to file a consolidated return, if such group has the right to file a consolidated federal return.
5. That the corporate net income tax should be amended to include in the numerator of the gross receipts allocation fraction only such classes of gross receipts, attributable to the Commonwealth, as are considered in the denominator.

The above changes in the corporate net income tax law would slightly decrease its yield, but by an indeterminable amount. It is the general opinion that no significant change in revenue would result from these recommendations.

A recommendation, appearing under Taxes on Insurance Companies, in this chapter, that all insurance companies be exempted from the corporate net income tax, would result in decreasing the General Fund's revenues from this tax by about $100 thousand biennially.

CAPITAL STOCK-FRANCHISE TAX

The present favorable condition of the state's finances makes possible the amelioration of the excessive tax on corporate enterprise, a major element of which is the capital stock-franchise tax. With a possible exception of Massachusetts, the Pennsylvania capital stock and franchise tax rate is the highest, imposed by any state in the union. Furthermore, the basis of Pennsylvania's capital stock and franchise tax is *the actual value of the capital stock,* a base which not only increases the severity of our levy, *but which is not used in any other state.*

The capital stock-franchise tax has long been considered the backbone of Pennsylvania's tax system. Prior to 1941, it produced a greater share of the general revenues of the state than any other tax; and this was true even after the exceedingly productive consumption taxes on liquors, malt beverages, and cigarettes, as well as the corporate net income tax, were enacted. In the 1941-1943 biennium, however, the capital stock-franchise tax at the rate of 5 mills, which has been in effect since 1891, yielded first place to the corporate net income tax, as a revenue producer.

Furthermore, since the tax is imposed upon capital, it reacts sluggishly to economic conditions. As a principal component of the state's tax system, this relative stability has great advantages, but this very stability makes it especially onerous upon corporations, because, by the same token, its burden does not vary with changing economic conditions or with ability to pay.

The Manufacturing Exemption

As has been demonstrated earlier in this report, the burden of taxation upon corporate enterprise in Pennsylvania is disproportionately heavy. The manufacturing exemption was, in part, a recognition of this fact. In addition, the "manufacturing exemption", which in the past exempted from the capital stock tax the capital investment of domestic and foreign companies, when actually invested or employed in manufacturing within the state, implemented a policy to encourage manufacturing in the state and thus promoted the utilization of Pennsylvania's peculiarly appropriate resources of labor and raw materials to the advantage of its citizens. Manufacturing plants provide the basic payrolls, upon which the prosperity of our cities and farms depend.

The manufacturing exemption was invalidated in 1935, but has strong claims to support its survival. It was in force during the fifty years, which saw the development of Pennsylvania's industrial preeminence. Furthermore, it is the subject of a "promissory note", of reasonably certain, though indefinite maturity, now on the statute books. If it be asserted that the manufacturing exemption is inconsistent with the theory that all enterprise should bear a share of the tax burden, a partial answer is to be found in the corporate net income tax, the bulk of which is paid by corporations, engaged in manufacturing.

Wise economic planning for the state, as a whole, dictates restoration of the manufacturing exemption (repealed first in 1935 for a two-year period, and permanently repealed in 1937), as contemplated by the Act of March 27, 1943, (P. L. 762). This act will become effective on the first day of January, 1945, unless hostilities of the present war have not ceased by that time, in which event the act will become effective on the first day of the first calendar year, beginning after the date of the cessation of hostilities in the present war. The exemption, as granted, will apply only to the calendar year, when this act becomes effective or for any fiscal year, beginning in such calendar year, and for each calendar or fiscal year thereafter. The new law follows the old pattern of restoring the exemption from the capital stock tax to capital stock, which is invested in and actually and exclusively employed in carrying on manufacturing within the state, except for companies, engaged in the distilling of liquors, and those which enjoy the right of eminent domain. However, no provision is made for the restoration of the exemption to the capital stock of companies, organized for laundering and for the processing and curing of meats, their products, and by-products, which were exempted by special acts in 1913 and 1929, respectively.

To safeguard the individual investor against potential liability for the county personal property tax on the shares, which he may hold in a manufacturing corporation, found to be entitled to exemption from the state capital stock or franchise tax, it will be necessary to revise Section 1 of the County Personal Property Act of June 17, 1913, as amended, by making it inapplicable to shares of stock "liable to *or relieved from* the payment of the state capital stock or franchise tax".

A strong case can also be made for a preferential rate of 2 mills only in the capital stock tax on coal mining and oil extraction companies, in contrast to the normal rate of 5 mills. Although extractive industries, unlike manufacturing plants, cannot move to other states to escape adverse economic factors, the production of coal and oil can, and does, gravitate to localities, where favorable conditions prevail.

Companies, not engaged in manufacturing, coal mining, or oil extraction should also be encouraged by a reduction in the rate of the capital stock-franchise tax from 5 to 4 mills. As previously pointed out, all corporate enterprise in Pennsylvania is relatively overtaxed in comparison with other states.

Consequently, the Tax Advisory Committee recommends:

1. That the capital stock-franchise tax be retained as a state tax.
2. That the prospective exemption of manufacturing capital from the capital stock-franchise tax be undisturbed.
3. That the shares and personal property holdings of corporations, liable to or relieved from the capital stock-franchise taxes or liable to a tax on shares, the gross premiums, the gross receipts,

and the net earnings taxes, be exempted from the county personal property tax.

4. That a preferential rate of not more than two mills be applied to capital, engaged in coal mining and oil extraction in Pennsylvania.
5. That the capital stock-franchise tax rate be reduced from five to four mills.

The revenue effect of the above recommendations and those, made later in this Chapter, with respect to taxes on insurance companies, would reduce the General Fund's biennial revenues by about $15 million (in terms of 1943-1945 revenues). This amount is comprised of estimated reductions of $13.3 million, resulting from the change in the capital stock tax rate from 5 to 4 mills, and $1.5 million, due to a preferential rate of 2 mills, proposed for coal mining and oil extraction companies, and $160 thousand from the preferential rate of 2 mills for domestic stock fire, and marine, insurance companies.

The decrease in revenue, resulting from the restoration of the manufacturers' exemption, as legislated by the General Assembly in 1943, is estimated at $14 to $16 million, biennially.

TAXES ON INSURANCE COMPANIES

All foreign insurance companies are taxed by the Commonwealth by a single tax of 2 percent imposed upon their gross receipts, derived from Pennsylvania business. Despite its obvious advantages and widespread use for the taxation of insurance companies, the gross premiums tax has never been extended to all domestic insurance companies, nor has it been applied as the exclusive method of taxing such domestic companies, upon whose business it has been imposed.

At the present time, the gross premiums tax is imposed at the rate of 8 mills only upon domestic stock fire, marine (except marine underwriters) and casualty insurance companies.

Domestic stock insurance companies, however, are subject to the capital stock and corporate net income taxes, while domestic mutual insurance companies are subject to no tax whatsoever. This results in the anomalous situation of subjecting domestic stock fire, marine, and casualty insurance companies to three state taxes, namely, on gross premiums, capital stock, and corporate net income; domestic stock life insurance companies to two state taxes, namely, those on capital stock and corporate net income; and the domestic mutual insurance companies, to no state tax.

It is, of course, apparent that domestic mutual insurance companies enjoy a competitive advantage taxwise over, not only similar foreign stock insurance companies, but also similar foreign mutual insurance companies. They likewise enjoy an advantage over domestic stock insurance companies, writing similar business. It follows that, if the burdens of taxation have been equitably distributed among foreign mutual and stock insurance companies and domestic stock insurance companies, domestic mutual insurance companies have escaped their fair share of the burden, to the extent that competitive relationships furnish a criterion.

An analysis of the relative state tax burdens upon domestic stock insurance companies and foreign insurance companies reveals that domestic fire and marine stock insurance companies are at a decided competitive disadvantage with all foreign insurance companies in similar lines, doing business in Pennsylvania. It also indicates that other domestic stock insurance companies are subject to nothing like the tax burden, imposed upon their foreign competitors.

These competitive situations between foreign and domestic insurance companies could be made less extreme by extending the gross premiums tax to domestic mutual insurance companies, reducing the capital stock tax upon fire and marine domestic stock insurance companies, and exempting all domestic stock companies from the corporate net income tax.

It also seems equitable that domestic mutual insurance companies bear some part of the state tax burden. This is emphasized by the fact that foreign mutual insurance companies, doing business in the State, are as heavily taxed as foreign stock insurance companies. The imposition of an 8 mill gross premiums tax upon domestic mutual insurance companies would still give them a tax advantage over foreign stock and mutual insurance companies, as well as domestic stock insurance companies, but it would mitigate, to some extent, present inequities of taxation.

The proposals of the Tax Advisory Committee would continue the present 2 percent gross premiums tax on foreign insurance companies and reduce to two the number of taxes, imposed upon any domestic insurance company. To the extent that they would no longer be subjected to the corporate net income tax, both domestic stock fire and marine and casualty insurance companies would be benefited. This would measurably increase the competitive advantage, which domestic casualty insurance companies have over similar foreign insurance companies, but in this case such resulting advantage would be more proportionate to that proposed in the case of other domestic insurance companies.

The Tax Advisory Committee is of the opinion that domestic stock fire and marine insurance companies are entitled to even more substantial relief. Prior to 1935 these companies were subject to a 3 mill instead of a 5 mill capital stock tax. A restoration of this special rate would still leave them at a competitive disadvantage with respect to their foreign counterparts. It appears necessary, in order to equalize the competitive situation with similar foreign insurance companies, to reduce, from 5 to 2 mills, the rate of the capital stock tax on domestic stock fire and marine insurance companies.

Finally, the proposals of the Tax Advisory Committee would simplify and rationalize the taxation of foreign and domestic insurance companies. The gross premiums tax would be recognized as the most efficient method of taxing insurance business by extending it to all companies, with the exception of domestic stock life insurance companies, which would be exempted due to special circumstances. Domestic stock insurance companies would pay only the capital stock tax in addition to the premiums tax and, consequently, no company would be subject to more than two taxes. Special recognition would be given to the present unfavorable situation of domestic fire and marine insurance companies by a preferential capital stock tax rate of 2 mills. By these means the most extreme competitive inequalities would be eliminated.

The extension of the gross premiums tax to domestic mutual insurance companies would, as a result of a provision in the Fiscal Code of the Commonwealth, nullify the present ordinances of the City of Philadelphia, imposing a two percent tax upon the premiums of mutual life and fire insurance companies, derived from business, written in that city. The dedication of the state gross premiums tax to school districts, as proposed by the Tax Advisory Committee, however, would more than compensate for this local revenue loss, which would be confined to Philadelphia.

Consequently, the Tax Advisory Committee recommends:

1. That the gross premiums tax be changed from a state tax to a state collected tax, dedicated to the public school system.
2. That the eight mill gross premiums tax, now imposed with respect to the premiums of domestic stock fire, marine, and casualty companies be extended to the premiums of all domestic mutual companies.
3. That all insurance companies be exempted from the corporate net income tax, which is presently imposed upon domestic stock fire, marine casualty, and life companies.
4. That domestic stock fire and marine companies be separately classified for capital stock tax purposes and taxed at the rate of two instead of five mills.
5. That, because of almost universal acceptance, the two percent tax upon the premiums of all foreign insurance companies, both stock and mutual, with the present reciprocal features, be retained.

Revenue changes, effected by these recommendations, would result in increasing the biennial yield of the state gross premiums tax by about $800 thousand, (in terms of 1943-1945 revenues), while decreasing capital stock tax biennial revenues by $160 thousand, and corporate net income tax revenues by $100 thousand, as already noted in the preceding sections on those taxes. The biennial revenue loss to the City of Philadelphia is estimated at about $270 thousand.

The dedication of the gross premiums tax to school district purposes would decrease General Fund revenues by $16.4 million biennially (in terms of 1943-1945 revenues) but add about $17.2 million to biennial school district revenues.

TAXES ON BANKING INSTITUTIONS

Equity requires that the shares of all banking institutions be now taxed at the same rate and on the same base. The competitive advantages, once enjoyed by title insurance and trust companies—the principal of which was the "trust powers"—no longer exist. Hence, the shares of title insurance and trust companies should be taxed at the rate of four mills, as are those of state and national banks.

Tax equality among financial institutions would also be promoted by subjecting the paid-up shares of both state and federal building and loan and savings and loan associations to the county personal property tax.

Similarly, the net earnings tax of 1889 should be made applicable to credit unions.

The Tax Advisory Committee, therefore, recommends:

1. That the rate of the tax on the shares of title insurance and trust companies be reduced from five to four mills, thus equaling the rate, imposed on shares of national and state banks or savings institutions.
2. That a provision, imposing a tax, similar to that formerly imposed by the Act of 1897, and applicable to both state and federal building and loan and savings and loan associations, be added to the county personal property tax act.
3. That the net earnings tax be extended to credit unions by appropriate amendment to the act, under which they were created.

The above recommendations would effect a revenue decrease of less than $600 thousand biennially in General Fund revenues, since the revenue, added by the net earnings tax on credit unions, would offset, in a slight degree, the revenue decrease, resulting from the reduction from 5 to 4 mills, in the tax on shares of title insurance and trust companies.

The taxation of the shares of state and federal building and loan and savings and loan associations under the county personal property tax would increase county revenues by about $600 thousand biennially.

BONUS

Analysis of the organization and registration fees and taxes of the several states discloses that the Pennsylvania "bonus", both on domestic and foreign corporations, is the highest levy of its kind in the Union. Revenue from the bonus is most unstable and it is doubtful whether the amount involved really justifies either an annual report from almost every corporation, doing business in the state, or the administrative personnel, required to handle these reports.

The Tax Advisory Committee recommends:

1. That the acts, imposing bonus on domestic and foreign corporations, be repealed.

The repeal of the corporation bonus would decrease General Fund revenues by about $900 thousand biennially.

TAXES ON PUBLIC UTILITIES

In order to prevent the destruction of a large part of the utility tax base and to prevent the shifting of taxes from certain communities to others, it seems quite clear that some form of taxation must be applied to utility business, operated by municipalities and municipal authorities.

The Committee proposes that the gross receipts tax be extended to all receipts from the primary services, furnished by all publicly and authority-owned utilities, and by all utilities, operated by co-operative associations, to the extent that such receipts of privately owned utilities are taxed. The present tax of ten cents per member, payable by rural electric corporations, should be abolished.

Private water companies are included in the foregoing recommendation, in order to assure the constitutionality of the extension of the gross receipts tax to municipal and authority-operated water supply systems.

The Act of 1931, imposing a gross receipts tax on motor transportation, produces practically no revenue and involves about 17,000 reports annually. It should be repealed with respect to passenger transportation, and the gross receipts tax should be imposed on motor carriers of freight, without the benefit of their present offsets against the tax.

Unincorporated motor transportation business should be subjected to a tax on net income.

Consequently, the Tax Advisory Committee recommends:

1. That the application of the gross receipts tax be limited to receipts from the primary service, for which the utility is organized.
2. That the gross receipts tax be extended to receipts from the primary service, furnished by all publicly and authority-owned utilities, and by all utilities, operated by co-operative associa-

tions, to the extent that such receipts of privately owned utilities are taxed, and that the present tax of ten cents per member, payable by rural electrical corporations, be abolished.

3. That the twenty-third section of the Act of 1889 be extended so as to include the taxation of gross receipts of private water companies.
4. That the utility gross receipts tax be retained as a tax in lieu of a local tax on real estate and that it be changed from a state to a school district tax, state collected.
5. That the Act of 1931, imposing a gross receipts tax on motor transportation, be repealed with respect to passenger transportation, and that the Act of 1889, imposing a tax on gross receipts, be amended to exempt motor transportation of passengers from the tax.
6. That the gross receipts tax be imposed on motor carriers of freight and that the tax exemptions, which they now have, be removed.
7. That the Act of April 28, 1899, P. L. 72, relating to express companies, be repealed.
8. That the gross receipts tax law be restated and clarified, its administration simplified, and annual rather than semi-annual reports be required.

These recommendations would have a fiscal effect of decreasing the revenues of the state's General Fund and Motor License Fund (in terms of 1943-1945 revenues) by $8.4 million and $.048 million, respectively. School district biennial revenues would be increased by $9.926 million, of which $1.586 million would result from the proposed revision and extension of the present tax on the gross receipts of public utilities.

EXCISE TAXES

With regard to the excise taxes, presently levied by the Commonwealth, the Tax Advisory Committee recommends:

1. That the malt beverage tax be retained as a state tax.
2. That the liquor sales tax (ten percent) be made a permanent part of the state's tax system.
3. That the cigarette tax be retained and made a permanent part of the state's tax system.
4. That the regular three cent tax on gasoline be continued.

5. That the emergency liquid fuels tax of one cent be allowed to lapse at the end of the present biennium (1943-1945).
6. That the "Spirituous and Vinous Liquor Tax Law" be repealed.

These recommendations would decrease the state's General Fund (in terms of 1943-1945 revenues) by $22.600 million of emergency liquid fuels tax revenues and $40 thousand of spirituous and vinous liquor tax revenues, a total of $22.640 million, biennially.

CORPORATE LOANS TAX

Although superficially it would seem that collection of taxes "at the source" is an economical and efficient device, it has not proved to be so in the case of the corporate and municipal loans taxes. This is because under present law the identity and residence of the holder of each item of indebtedness determines whether that item is subject to tax. This circumstance has complicated the administration of the tax, imposed upon the reporting corporations, the municipalities, and the state an almost intolerable burden of detail, and generally made the overall cost of collecting the tax very high.

The treasurer of each corporation and municipality is required to establish and report the identity and residence of each holder of its corporate indebtedness. Unless positive proof of non-taxability is presented, the item is considered taxable, regardless of the diligence, exercised in this connection.

It has been estimated by one large corporation that the expense, to which it alone is put in assembling information as to holders and in collecting and reporting the tax, exceeds 20 percent of the tax, actually paid to the state at the normal rate of 4 mills. This, of course, does not include the expense to the state in carrying on the operations, outlined above, in connection with collections of the tax.

Furthermore, all this activity has certain aspects of futility. Less than 20 percent of all the loans of private corporations are in taxable hands, although every holder, regardless of identity or residence, must be reported.

Consequently, the Tax Advisory Committee recommends that the taxes on corporate and municipal loans be abolished and that the obligations, now taxable thereunder for state purposes, be subjected to the county personal property tax and taxed exclusively for county purposes. Since the corporation and municipal loans taxes are now imposed under the Act of 1937, and, since the section, pertaining to those taxes in the 1931 Act, has been repealed, this recommendation may be accomplished by repealing the former act and making appropriate amendments to Section 1 of the latter.

Consequently, the Tax Advisory Committee recommends:

1. That the corporate loans tax be abolished and the obligations taxed thereunder be subjected to the county personal property tax.
2. That the municipal loans tax be abolished and the obligations taxed thereunder be subjected to the county personal property tax.
3. That the provisions of the taxing statutes be redrafted and rearranged to eliminate excess verbiage and clarify the meaning.

The revenue effect of these recommendations (in terms of 1943-1945 revenue) would be to shift about $5.3 million from the corporate loans tax and about $3.1 million from the municipal loans tax, a total of $8.4 million biennially, from the state's General Fund to the counties for general purposes.

NEW SOURCES OF REVENUE

At the outset of the studies, made by the Tax Advisory Committee, the individual net income tax was rejected as a new source of revenue because of constitutional difficulties in Pennsylvania, as well as because of present heavy federal levies on personal income. A general tax on gross income or earnings, such as is found in the State of Indiana, was considered by the Committee, but dropped, because it would involve a reconstruction of the entire tax system of the state, and involve the elimination of several sound, well-tested revenue producers for the state.

Everything considered, a general retail sales tax was finally decided upon as offering the best means of incorporating into the Pennsylvania tax system a long needed broad-based tax, which would result in direct support of the government by the citizens of the Commonwealth, all of whom receive its protection and benefits, both state and local.

The studies of the Tax Advisory Committee developed that Pennsylvania is one of only 10 states that had neither a personal income nor a general retail sales tax.

Retail sales taxes were found to be operating presently in 23 states of the Union. The tax is paid directly by the consumer out of income and earnings; it is not levied on capital or production, so essential to postwar prosperity. By notice of the addition of the tax to the cost of the commodity, the taxpayer is made fully conscious of a sales tax at the time of making a purchase, and he can measurably protect himself against the tax, if he so desires, by curtailing his spending for luxuries and unnecessary items.

A state-collected sales tax of $2\frac{1}{2}$ percent on tangible personal property would broaden and round out Pennsylvania's tax system and make possible a substantial reduction in the present unduly high local realty tax burden by the dedication of the sales tax proceeds exclusively to the support of the public schools of the Commonwealth.

Tangible personal property, now subjected to selective state sales tax, viz., liquor, cigarettes and gasoline, would be exempted from the proposed general state sales tax.

Since repeal of the state's mercantile license tax, unincorporated business in the state is subjected only to those state taxes, which fall upon the individual citizen. In view of the greater demands of such business upon government services, as well as the competitive advantage, now given to unincorporated business over incorporated business, it is thought proper that unincorporated business should pay a state tax on net income at a rate comparable to that imposed on corporations. The proceeds of the tax would be earmarked for local government purposes.

Consequently, the Tax Advisory Committee recommends:

1. That for the purpose of bringing about a reduction in local taxes on real estate, state taxes, dedicated for public school purposes, be levied in the form of a state sales and compensating use tax at the rate of two and one-half percent, to supplement the proposed shift of the utilities gross receipts tax and the insurance premiums tax (state-collected) to the use of school districts for the same purpose.[1]

[1] This recommendation is repeated and fully discussed in Part II of the Report under "New Sources of Revenue," and Part III, under "School Districts."

2. That a tax on unincorporated business be imposed at the same rate as on incorporated business, and be state-collected, but dedicated to the political subdivisions of the Commonwealth.[1]
3. That the State Constitution be amended to permit uniform basic exemptions for income, inheritance, estate, and excise taxes.

These recommendations would result in biennial revenues (in terms of 1943-1945) of $152 million for school districts from the sales tax and $25 million for counties and municipalities from the unincorporated business tax. The slight revenue effect of uniform basic exemptions for certain taxes is not determinable.

STATE TAX ADMINISTRATION

Good tax administration requires well qualified personnel, as well as good taxing standards and regulations. The two taxing departments of the state have capable and well-trained personnel at the present time, but it is possible that many of these employes will gradually withdraw from state service, unless certain adjustments in job classification and salary are soon made. Many capable men have left these taxing departments in the last three years.

To retain such men and make a career for them in the Commonwealth service, there is need for a thoroughgoing study of the present classifications and salaries of those employes in the two taxing departments, who make or supervise the making of corporate tax settlements and resettlements.

Furthermore, civil service status should be applied to employes of the Bureau of Corporation Taxes and the Receipts Accounting Section of the Department of Revenue, as well as the Taxing Bureau of the Auditor General's Department.

Reconstitution of the Board of Finance and Revenue is long overdue. The five members of the board are all full-time state employes in other capacities. The result is that the Board of Finance and Revenue meets only once each month for public hearings. Some hearings take only a few minutes, while others involve complicated and confusing legal consideration.

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[1] This recommendation is repeated and fully discussed in Part II of the Report under "New Sources of Revenue," and Part III, under "Reallocation of Governmental Functions."

Members of the Board, as presently constituted, simply review the work of their departments in many cases. Furthermore, the member from the Department of Justice is in the anomalous position of passing judgment on matters, in which he may later have to serve as an advocate. All members have other duties and cannot give to the tax problems before the Board the time, which they deserve.

It is believed that the Board would be much improved, if it were reconstituted as an independent board of three full-time members, relieved of present functions, not having to do with state taxation and escheats. The three members should have a thorough knowledge of state tax practice and be required to devote their full time to these duties. The qualifications and salaries of the members should be specified by statute.

In fairness to the taxpayer, many procedural changes should be made in state tax administration and, for the sake of economy in the Commonwealth's fiscal operations, likewise in the state's tax calendar.

The Tax Advisory Committee, therefore, recommends:

1. That a thoroughgoing study be made of the present classifications and salaries of all employes in the two taxing departments, who make or supervise the making of corporate tax settlements and resettlements.
2. That civil service status be applied to the Bureau of Corporation Taxes and Receipts Accounting Section of the Department of Revenue, and the Taxing Bureau of the Auditor General's Department.
3. That the existing Board of Finance and Revenue be eliminated and, in lieu thereof, an independent administrative commission be established, to consist of three full-time members; and that the taxation and refund functions, now vested in the Board of Finance and Revenue, be transferred to the new commission; and that existing administrative functions, relating to state depositaries, rate of interest, etc., be vested in some existing department, most appropriate for these functions.
4. That the corporate net income, capital stock, and franchise tax reports be filed five and one-half months after the close of the fiscal year or calendar year, and the tax be paid concurrently therewith.
5. That there be a limitation of the interest charge, where tax settlement cannot be made within one year from date report is filed.

6. That the Fiscal Code be amended to provide not more than four percent interest on tax credits and refunds. This should apply to over-payments of state taxes, resulting in open or free credits and cash refunds, where such over-payments in the form of open or free credits result from action, taken under Section 1105 of the Fiscal Code, or from action, taken on petition for resettlement, petitions for review, appeal, or petitions for refund.
7. That interest on deficiencies be reduced from six percent to four percent.
8. That an appropriation be provided to allow tax refunds or credits to be made in cash, in cases where the taxpayer certifies that he has no immediate use for the credit refund.

The fiscal effects of the above recommendations on the General Fund would increase revenues, available for appropriation, from $2 to $3 million biennially, due to the elimination of short term borrowing and the consequent interest payments on tax anticipation notes, resulting from changes in the tax calendar. The estimated biennial loss of General Fund revenue, due to reduction of the state's tax penalty interest rate and payment of interest on tax credits and refunds, would be about $500 thousand.

The adjustment of the tax calendar would, however, absorb approximately $87 million of the current surplus of the General Fund, for, in effect, the Commonwealth, since 1937 has been to that extent using revenues, applicable to the next fiscal year, to finance expenditures of the current fiscal year.

CHAPTER 3

SUMMARY OF COMMITTEE RECOMMENDATIONS WITH RESPECT TO REALLOCATION OF GOVERNMENTAL FUNCTIONS

A careful study of the present state-local functional relationships shows that it is possible and highly desirable to strengthen local governments in their proper spheres of activity by an interchange of certain functions among the Commonwealth and its political subdivisions. At the same time, such action would afford considerable relief to local taxation through the transfer of certain functions and their costs to the state, as well as by the addition of new local revenues and tax sources. By the adoption of new, broadly-based taxes, dedicated to specific local purposes, to replace or supplement present state grants to the political subdivisions of the state, the overall cost of government can be more widely distributed and the tax burden more equitably allocated. Finally, state grants to political subdivisions should be redetermined and simplified in order to provide more effective formulæ, so that those sections of the Commonwealth, which most need financial assistance, will receive the greatest benefit.

Recommendations to achieve these interrelated objectives are an essential part of any well-conceived program for strengthening the financial structure of state and local government, so as to avoid in the postwar period the mistakes of the past and eliminate all undue burdens on any portion of the state's economy. Furthermore, constructive reorganization of the functions, responsibilities, and revenues of state and local governments will discourage recent excessive local reliance upon extraordinary federal or state grants to provide the funds to carry on those activities, held to be essentially local in nature and requiring local control and responsibility.

The distribution of tax sources among the state and its political subdivisions is at the discretion of the state legislature. Local government taxation (with the exception of permissive taxes for Philadelphia alone) is restricted by state law to specific taxes upon classified subjects. The principal tax source of the Commonwealth's political subdivisions is the tax on real property, which is employed by all units of local government. There are, in addition to the tax on real property, local taxes on intangible personal property, per capita, and occupations, and some minor special taxes.

School Districts

School districts in 1942 accounted for about 44 percent of the total expenditures of all local governments of the Commonwealth and received about 48 percent of the real estate taxes, collected in the Commonwealth. They received about 76 percent of their revenues from real estate (including minor per capita tax revenues) and about 24 percent from state grants. The methods, now used for distributing these state grants among the 2,500 school districts are largely based on the principle that school districts, with the least resources, should receive the largest grants. The proportion of state grants to total revenues of school districts is very unequal, ranging in 1942 from 8.2 percent in first class districts up to 40.3 percent in fourth class districts.

The formula, proposed to remedy the weakness in the present method of distributing state grants to the school districts, recognizes that the current manner for determining school district resources, on the basis of assessed valuation, makes for inequitable treatment of certain classes of school districts, as well as individual school districts. It is proposed by the Tax Advisory Committee to distribute $1,600 per teaching unit, based on a pupil-teacher ratio of 33 in first class school districts, 30 in second and third class school districts, and 25 in fourth class districts. Where it is not feasible for fourth class school districts to maintain teaching units of 25 pupils, each employed teacher would be considered as a teaching unit. Transportation would also be provided in fourth class school districts and state appropriations from the proceeds of the dedicated taxes would be continued for salary and expense payments to county and assistant county superintendents, county boards, and for other small miscellaneous payments.

Although it is not an essential feature of the proposed school formula, a system of county school districts is a fundamental requirement for better administration of the school system, and it is, therefore, proposed that the county be established as a unit of school administration for third and fourth class school districts, except that municipalities of more than thirty thousand population will each constitute a school district.

The plan of financing the state-wide $1,600 teaching unit would provide $179.1 million per biennium, through the dedication of the proceeds from the state sales and compensating use tax at the rate of

2½ percent, the utilities gross receipts tax, and the insurance premiums tax to the exclusive use of the school districts. The cost of the proposed program for the school districts, including the payment for salaries and expenses to county and assistant county superintendents and other similar expenses, would amount to about $171 million per biennium, leaving a balance of $8 million.

The proposed plan would permit the abolition of the present per capita school district tax, and if accompanied by the imposition of a tax ceiling on school district real estate levies, would result in substantal reductions in real estate taxation for school purposes of somewhere between thirty and sixty million dollars per biennium. It would give firm support for a state-wide minimum educational program through adequate financing, equalized educational opportunities throughout the state, and reduce the number of financially distressed districts, now compelled to make annual appeals for special aid from the Commonwealth. Finally, the county unit plan would lead to improvement of school administration within each county and to a substantial reduction in the high overhead costs of administration in the more than 2,500 school dstricts of the Commonwealth.

In the 1943-1945 biennium, state grants, appropriated from the General Fund for public school purposes, amounted to $119.6 million. The Committee's proposed program would provide $179.1 million, or $59.5 million over and above present state grants from the General Fund.

Consequently, the Tax Advisory Committee recommends:

1. That for the purpose of giving relief to the public school system and bringing about a reduction in taxes on real estate throughout the Commonwealth, state taxes dedicated for public school purposes to provide $1,600 per teaching unit, be raised by a state sales and compensating use tax at the rate of 2½ percent and by a shift of the utilities gross receipts tax and the insurance premiums tax (state-collected) to the use of the school districts.
2. That the proceeds from the state-dedicated taxes for school purposes be apportioned among the four classes of school districts on the basis of $1,600 per teaching unit, based on the following teacher-pupil ratios, viz: in first class districts, 33 pupils per teacher, in second and third class districts, 30 pupils per teacher, and in fourth class districts, 25 pupils per teacher.

3. It is the opinion of the Tax Advisory Committee that a reduction in the revenue requirements of individual school districts, which will necessarily result from the proposed plan, will permit a substantial reduction in the school district levies on real estate. This can only be assured by establishment of a ceiling by the General Assembly, on the amount, which may be assessed and collected from real estate for school purposes.
4. That the county be established as the unit of school administration, except that municipalities, having a population of more than 30,000, shall constitute separate school districts.

Public Assistance

Until 1931 public assistance was administered in Pennsylvania by local poor boards, which during the depression proved inadequate to deal with such a major economic emergency. This was especially true in poor districts comprising less than a county. Generally, the poor boards, coterminous with counties, had better administration, although they too failed to meet their responsibilities. Consequently, the General Assembly enacted a succession of special laws, and in 1937 finally replaced the inefficient poor boards with a completely centralized, state-financed, and state-administered system of outdoor assistance with programs for general assistance, old age assistance, aid to dependent children, and blind pensions. All cases of institutional care, except for mental diseases and cases, that could not be brought under the programs of the centralized system, remained under the newly-constituted county institutional districts.

The outdoor relief programs of public assistance have functioned very well, due to the enforcement of uniform standards and regulations in every part of the Commonwealth by the State Department of Public Assistance. The legislation of 1937, however, impaired two essential features of government by (1) removing all local responsibility for the care of indigent and needy, insofar as outdoor relief is concerned, and (2) furthering an inorganic separation of the various functions of health and welfare, which are inextricably bound together.

The present problem, therefore, is to restore the principle of local responsibility for the administration and financing of public assistance, without losing any of the benefits, achieved during the past decade. This result can be accomplished by joint state-local administration and support of public assistance, wherein the state's Department of Public Assistance determines the general principles, policies, and minimum standards for all programs of public assistance, gives consideration to the requirements of the state and the various counties, and establishes rules, regulations, standards, and supervision of local administration. The local administration would be performed by county boards of public assistance, whose members would be locally appointed by, and responsible to, the county government. The present functions of the institution districts, now administered and financed solely by the counties, would be divided, so that every kind of institutional care would be taken over by the state, while foster home care, other forms of child welfare, and all cases of relief, not cared for in institutions, would be merged with the functions of the county boards of public assistance.

The Committee proposes to provide for the financial requirements of such a program of public assistance by a basic contribution from the counties, with a major portion of the total cost to be supplied by the state. The basic contribution of the counties should not exceed 50 percent of the total expenditures (exclusive of federal grants). It is estimated that the counties' share of public assistance, ranging from 30 to 50 percent, would not exceed $32 million and the remaining costs, or about 60 percent of the total, would be provided by the state. This estimate takes into consideration the fact that there are many counties with greater needs and less ability to pay for public assistance than the average. They, consequently, will need a larger degree of state aid than those counties in more fortunate economic circumstances. To assist the counties in assuming their share of public assistance costs, the Committee recommends that the proceeds of a proposed new tax on the net income of unincorporated business be made available to the counties for this purpose, with the balance, not so used, distributed among the municipalities.[1]

Consequently, the Tax Advisory Committee recommends:

1. That all non-institutional welfare, including assistance, be declared the joint responsibility of the state and the counties, administered through the county commissioners, with the State Department of Public Assistance setting standards and the

[1] This recommendation is repeated and fully discussed in Part II, under "New Sources of Revenue," and Part III, under "Reallocation of Governmental Functions."

counties contributing a material portion of the amounts required.

2. That a state net income tax be imposed on unincorporated business at a rate equal to the rate imposed on incorporated business under the Corporate Net Income Tax Act and that the revenues from this tax be used first for county purposes, so as to enable counties to bear part of the cost of public assistance, and the amount, not needed for this purpose, be allocated to municipalities.

Institutional Welfare

Welfare functions, relating primarily to the institutional care of indigents, which became the responsibility of the counties and the Commonwealth in 1937, with each maintaining their separate and distinct institutions, have been further modified by the Mental Health Act of 1941, under which the state assumed responsibility for mental patients and all mental hospitals, formerly under the county institution districts. This action has lead to great confusion and unnecessary duplication of facilities and services.

Institutional welfare costs, now administered by the institution districts of the counties, have been estimated at approximately $22 million per biennium. The Committee's recommendation would shift these costs to the Commonwealth's General Fund and make institutional welfare the exclusive responsibility of the state, with such transfers of property from the local units to the Commonwealth, as may be required.

Consequently, the Tax Advisory Committee recommends:

1. That institutional welfare costs of county institution districts be the exclusive responsibility of the state, both financial and administrative, with such transfers of property as may be required.

Judiciary and Corrections

The judicial and correctional functions are administered by the Commonwealth and the counties, with the counties in 1942 assuming about 84 percent of the judicial costs, including those for the constitutional, county "fee" officers, and 58 percent of the cost for corrections. No jurisdiction over the courts is vested in the counties, but they are required by law to furnish such office supplies, employes, services, and quarters as the judges in each county may request.

The court employes, paid by the counties, include criers, tipstaves, jurors, stenographers, court reporters, and secretaries to judges. The county also pays the fees of the minor judiciary and constables and provides office supplies and equipment and other services. Under the Committee's proposed plan all these costs for the courts of common pleas, of oyer and terminer, quarter sessions and orphans' courts, the municipal court in the City of Philadelphia, and the county court in the County of Allegheny would be transferred to the Commonwealth. The counties, however, would continue to provide the existing housing quarters for the courts.

The Commonwealth and the counties both exercise the correctional function, which includes the maintenance of prisons, workhouses, reformatories, and industrial farms. At the present time penal offenders, sentenced by the county courts to state or semi-state institutions, are maintained at the expense of the counties, which pay a per diem charge to the Commonwealth. If the courts deem it advisable to commit certain offenders to state institutions, there seems little justification for considering the maintenance of such offenders as a matter of local concern. The correctional function, in its relation to this type of offender, is a matter of the general interest and can be conducted properly only at the state level. It is logical, therefore, that the state take over the entire responsibility, insofar as it applies to penal offenders, committed to state and semi-state institutions, from the counties, which have little jurisdiction over either the judicial or correctional aspects of this problem.

The transfer to the state of the costs of the judiciary, minor judiciary, and constables, as well as the maintenance of penal offenders in state and semi-state institutions, will relieve the county of biennial costs estimated at $15.5 million and $7 million, respectively, transferring these costs to the General Fund of the Commonwealth.

Consequently, the Tax Advisory Committee recommends:

1. That there be transferred to the Commonwealth from the counties all expenses, involved in the employment of criers, tipstaves, jurors, stenographers, and secretaries to judges, court reporters, and supplies for judges of the courts of common

pleas, of oyer and terminer, quarter sessions, and orphans' courts, as well as the municipal court in the City of Philadelphia, and the county court in the County of Allegheny, with counties continuing to furnish existing housing quarters for the courts.

2. That the expense, now incurred by counties in connection with minor judiciary and constables, be transferred to the state.
3. That the state bear the cost of maintenance of penal offenders in state and semi-state institutions (without charge to the counties).

Sanitation and Health

The Committee recommends encouragement of the development of municipal authorities to construct and operate trunk sewer lines and sewage disposal plants on a rental basis. Such developments would constitute a promising step in dealing with inter-municipal problems of health and sanitation and, likewise, would relieve municipal finances, since operation of such authorities would be financed on a fee basis, with all capital outlays on a revenue bond basis, leaving the general borrowing power of municipalities unimpaired.

The fact that communicable diseases cannot adequately be dealt with on a local basis and that the collection of vital statistics is properly a matter in which the state has a paramount interest is recognized by a recommendation of the Committee for turning these functions over to the state.

Consequently, the Tax Advisory Committee recommends:

1. That encouragement be given to the development of municipal authorities to construct and operate trunk sewer and sewage disposal plants on a rental basis, with all capital expenditures financed on a revenue bond basis.
2. That the health problem, so far as it relates to communicable diseases and vital statistics, be declared a state function.

Highways

A more equitable distribution of the tax revenues, dedicated to local highway purposes, seems warranted to correct certain results, arising from the present formula, which distributes liquid fuels tax funds to each county, on the basis of the average amount of gasoline sold within each county during the three year period, 1928-1930. The Committee proposes, therefore, that highway aid to local governments be revised and that both the present liquid fuels tax formula and highway grants to second class townships be eliminated. It is proposed that one cent per gallon of the present liquid fuels tax be dedicated to municipalities, according to a formula, based equally on population and miles of roads, locally maintained within each municipality. The use of such funds would be limited to the construction, improvement, and maintenance of roads, bridges, and tunnels.

The Committee also proposes to eliminate inequities, which now exist in regard to the payment of land damages in connection with state highways in cities, by granting to the Commonwealth the authority to lay out and construct state highways, bridges, and tunnels, paying all expenses, including property damages, without local participation, except by local consent, as is now the case in regard to such state construction in boroughs and townships.

These proposals would result (in terms of 1943-1945 revenue) in a biennial loss of $11.3 million of liquid fuels tax funds to the counties and $7 million in highway grants to second class townships. Municipalities, however, would receve, for the first time, $22.6 million of liqiud fuels tax funds per biennium. It is estimated that the loss of state grants by the second class townships would be approximately compensated by their share of the liquid fuels tax.

Consequently, the Tax Advisory Committee recommends:

1. That appropriations from the liquid fuels tax be made available in the amount of one cent per gallon to cities, boroughs, towns, and townships, distributable one-half on the basis of population and one-half on the miles of roads, such funds to be used for highway, bridge, and tunnel construction and maintenance, and the amortization of indebtedness, incurred at any time for road purposes, these grants to be in lieu of present appropriations from the Liquid Fuels Tax Fund and the Motor License Fund to counties and townships of the second class.

2. That the state be granted authority to lay out and construct state highways, bridges, and tunnels, paying all expenses, including property damages, without local participation, except by local consent.

Revenue Shifts to Counties

The Committee's overall plan includes recommendations that corporate and municipal loans taxes, now imposed by the state, be repealed and that these subjects of taxation be taxed under the county personal property tax law; that the stock of both state and federal building and loan and savings and loan associations be subjected to the county personal property tax; and that the tax on writs, wills, and deeds, and the fees on marriage licenses be shifted to counties. Altogether these proposals would increase biennial county revenues by $9.6 million, which would be available to the counties for general county purposes.[1]

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[1] These recommendations appear in full in Part II of this report under "Personal Property Tax."

CHAPTER 4

REVENUE AND OTHER EFFECTS OF THE TAX ADVISORY COMMITTEE'S PROPOSALS

The overall net effect of the Tax Advisory Committee's proposals would be a biennial net gain of $141.4 million in revenues, available to the Commonwealth and its political subdivisions. The distribution of this tax revenue increase, however, is effected by the recommendations, concerning the allocation of certain functions and their costs, so that, while there may not be an increase in actual revenue in some instances, there is a decrease in revenue requirements, which, consequently, increases the amount of net revenue, available for appropriation by the state or its political subdivisions. The biennial net gain to local governments would amount to $110.7 million, at least a substantial portion of which can be used for reducing local real estate tax levies. The biennial net gain of $30.7 million to the Commonwealth would provide an ample margin to offset the revenue loss, anticipated when the restoration of the manufacturers' exemption from the capital stock tax, enacted in 1943, becomes effective. Furthermore, it would more than compensate for the indeterminable, but slight, revenue losses, which would result from certain proposed amendments to the existing statutes, which levy the taxes on corporate net income, capital stock and foreign franchise, and other subjects.

The net revenue effects of the Committee's overall proposals are presented in Tables A and B below, and supported by Tables C and D, which in turn, respectively, summarize the revenue changes, resulting from the proposals for revision of the tax structure and those, growing out of the proposals for the reallocation of certain governmental functions and their costs.

TABLE A

OVERALL FISCAL EFFECTS OF THE TAX ADVISORY COMMITTEE'S RECOMMENDATIONS

I. Overall Net Effect on Commonwealth and Its Political Subdivisions

There would be a biennial net increase (in terms of 1943-1945 revenues) of $141.431 million in revenue, available for appropriation, by state and local governments, as follows:

State	Biennial Net Increase	$30.744
Local	Biennial Net Increase	110.687
State and local Governments	*Biennial Net Increase*	$141.431

II. Overall Fiscal Effect at State Level

1. *Fiscal Effect on General Fund*

A. General Fund biennial revenues, available for appropriation, would be *increased* $154.596 million (in terms of 1943-1945 revenues) by:

Increase in Tax Revenues		
Extension of net earnings tax	$.027	$.027
Transfers of Costs		
School grants from General Fund to be replaced by dedication to school districts of funds from proposed sales tax and revised taxes on utilities and insurers [1]	$119.569 [2]	
Partial cost (average 40 percent) of public assistance to be transferred to counties	32.000	$151.569
Decrease in Expenditures		
For Interest Saving on tax anticipation notes, due to changes in tax calendar	$3.000	$3.000
Total		$154.596

[1] For details of these dedicated funds, see page 60, Effect on School District Revenues.

[2] This is the total, appropriated for 1943-1945 school grants. It is made up of regular appropriations of $116.867 million, of which $40,000 was lapsed during the biennium, and deficiency appropriations of $2.742 million for 1943-1945 purposes.

TABLE A (Continued)

B. General Fund biennial revenues, available for appropriation, would be *decreased* $119.504 million (in terms of 1943-1945 revenues) by:

Transfers of Tax Revenues		
Gross premiums tax shifted to dedicated fund for school districts	$16.400	
Gross receipts tax shifted to dedicated fund for school districts	8.400	
Writs, wills, and deeds tax shifted to counties	.600	
Corporate and municipal loans taxes shifted to counties	8.400	$33.800
Decrease in Tax Revenues due to Rate Reductions		
Shares tax on trust companies—from 5 to 4 mills	.600	
Capital stock tax—from 5 to 4 mills and preferential rate for mining and oil extractive industries	14.800	
Preferential rate for domestic stock fire and marine insurance companies	.160	
Corporate Net Income Tax—exemption of insurance companies	.101	
Interest rate on delinquent taxes—from 6 to 4 percent	.898	$16.559
Taxes to be Repealed:		
Liquid fuels—one cent emergency rate, now deposited in General Fund	$22.600	
Stock transfer tax	1.100	
Domestic and foreign bonus	.900	
Spirituous and vinous liquor tax	.040	
Rural electric co-operative corporation membership tax	.005	$24.645
Transfer of Costs:		
Judiciary costs—from counties to state's General Fund	$15.500	
Cost of maintaining all penal offenders in state and semi-state institutions—to be shifted from counties to state's General Fund	7.000	
County institution district costs—to be shifted to state's General Fund	22.000	$44.500
Total		$119.504

2. *Fiscal Effect on Motor License Fund*

A. Motor License Fund biennial revenues, available for appropriation, would be *decreased* $11.348 million (in terms of 1943-1945 revenues) by:

Decrease in Tax Revenues	
Reduction of Motor License Fund's share of liquid fuels tax from 2½ to 2 cents per gallon	$11.300
Loss of highway use tax (gross receipts tax on interstate motor carriers)	.048
Total	$11.348

TABLE A (Continued)

B. Motor License Fund biennial revenues, available for appropriation, would be *increased* by $7 million, by:

Transfer of Expenditure	
Highway grants to second class townships—to be made from dedicated share of liquid fuels tax	$7.000

3. *Net Revenue Effect at State Level*

There would be a biennial *net increase* of $30.744 million in state revenue, available for appropriation, resulting from:

General Fund—*Biennial Net Increase*	$35.092
Motor License Fund—*Biennial Net Decrease*	4.348
Biennial Net Increase—State	$30.744

III. Overall Effect on Local Revenues

1. *Effect on County Revenues*

A. County revenues, available for appropriation, would be *increased* biennially (in terms of 1943-1945 revenues) by $79.1 million, by:

New Tax Revenues		
New state-administered tax on unincorporated businesses to be distributed to the counties for public assistance [3]	$25.000	
Building and loan company shares to be taxed by county as personal property	.600	$25.600
Transfer of Tax Revenues to Counties		
Corporate and municipal loans tax to be taxed by county instead of state	$8.400	
Writs, wills, and deeds tax and marriage license fees to be paid to county instead of state	.600	$9.000
Transfer of Costs		
Judiciary costs—to be assumed by state's General Fund	$15.500	
Cost of maintaining penal offenders in state institutions—to be assumed by state's General Fund	7.000	
County institution district costs—to be assumed by state's General Fund	22.000	$44.500
Total		$79.100

[3] The Committee recommended that municipalities receive a portion of this tax, not required for county purposes.

TABLE A (Continued)

B. County revenues, available for appropriation, would be *decreased* biennially (in terms of 1943-1945 revenues) by $43.3 million, by:

Reduction in Tax Revenues		
Loss of one-half cent per gallon of liquid fuels tax now dedicated to counties	$11.300	
Transfer of Costs		
Transfer to counties from state of partial cost of public assistance	32.000	
Total		$43.300

2. *Effect on School District Revenues*

A. Revenues, available for school districts, would be *increased* biennially (in terms of 1943-1945 revenues) by $179.126 million, by:

New Tax Revenue		
General sales and compensating use tax at rate of 2½ percent, dedicated to school districts	$152.000	
Transfers of Tax Revenue		
Dedication to school districts of General Fund's gross premiums tax, plus revenue effect of expansion of tax	17.200	
Dedication to school districts of General Fund's gross receipts tax on public utilities, plus revenue effect of expansion of tax	9.926	
Total		$179.126

B. Revenues, available for school districts, would be *decreased* biennially (in terms of 1943-1945 revenues) by:

Loss of General Fund school grants (in millions)		$119.569 [4]

[4] See footnote [2] this table,.

TABLE A (Concluded)

3. *Effect on Revenues of Municipalities*[5] (cities, boroughs, towns, and townships)

A. The revenues of municipalities would be *increased* biennially (in terms of 1943-1945 revenues) by:

Dedication to municipalities for highway purposes of one cent per gallon of the liquid fuels tax, amounting to (in millions)		$22.600

B. The revenues of municipalities would be *decreased* $7.270 million, biennially (in terms of 1943-1945 revenues) by:

Reduction in Tax Revenues		
Philadelphia tax on domestic mutual insurance companies—void, if taxed by state [6]	$.270	
Loss of state Grant		
Discontinuance of highway grants to second class townships, now made from Motor License Fund	$7.000	
Total		$7.270

4. *Net Effect on Local Revenues*

There would be a net biennial *increase* of $110.687 million (in terms of 1943-1945 revenues) in revenue, available for local governments, distributed as follows:

Counties [7]	........Biennial Net Increase	$35.800
School Districts	....Biennial Net Increase	59.557
Municipalities [7]	....Biennial Net Increase	15.330
Local Governments	..*Biennial Net Increase*	$110.687

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[5] See footnote [3] this table, in regard to unincorporated business tax.

[6] This would affect Philadelphia only.

[7] All of the state-administered tax on unincorporated businesses, recommended for distribution to counties and municipalities, is credited to counties.

TABLE B

NET BIENNIAL EFFECT ON THE FUNDS OF THE COMMONWEALTH AND ITS POLITICAL SUBDIVISIONS OF PROPOSED REALLOCATION OF GOVERNMENTAL FUNCTIONS AND REVISION OF THE TAX STRUCTURE[1]

(in millions of dollars)

Subdivision	*Effect on Tax Revenues of Tax Changes*[2] *Increase*	*Effect on Tax Revenues of Tax Changes*[2] *Decrease*	*Effect on Revenues of Transfers of Functions or Changes in Grants*[3] *Increase*	*Effect on Revenues of Transfers of Functions or Changes in Grants*[3] *Decrease*	*Net Effect on Biennial Revenues Increase*
School Districts[4]	179.126	......	......	119.569[5]	59.557
Counties	34.600	11.300	44.500	32.000	35.800
Municipalities	22.600	.270	......	7.000	15.330
Total—Local	236.326	11.570	44.500	158.569	110.687
State Fund					
General Fund	3.027	75.004	151.569	44.500	35.092
Motor License Fund	......	11.348	7.000	......	— 4.348*
Total—State	3.027	86.352	158.569	44.500	30.744
Total—State and Local	239.353	97.922	203.069	203.069	141.431

* Decrease.

[1] Based on 1943-1945 state revenue.

[2] For supporting detail, see Table C.

[3] For supporting detail, see Table D.

[4] Although shown as local revenue, this would be actually a new state fund to be established for state-collected monies, dedicated to school districts.

[5] Includes deficiency appropriations to be made for 1943-1945 school grants from the General Fund.

ANALYSIS OF BIENNIAL EFFECTS OF TAX REVISION ON STATE FUNDS AND LOCAL REVENUES

(in millions of dollars)

Change in Tax Revenues	Commonwealth's General and Motor License Funds [1] Increase	Decrease	Local Revenues Increase	Decrease	Net Overall Change in Biennial Tax Revenues Increase	Decrease
Sales and Compensating Use Tax—New	......	......	152.000 [4]	......	152.000	......
Unincorporated Business Tax—New	......	......	25.000 [5]	......	25.000	......
Gross Premiums Tax—Shifted and Increased	......	16.400	17.200 [4]	......	.800	......
Gross Receipts Tax—Shifted and Increased	......	8.448 [2]	9.926 [4]	......	1.478	......
Writs, Wills and Deeds Tax—Shifted	......	.600	.600 [5]	......	......	......
Corporate Loans Tax—Shifted	......	5.300	5.300 [5]	......	......	......
Municipal Loans Tax—Shifted	......	3.100	3.100 [5]	......	......	......
Building and Loan Co. Shares (Personal Property Tax)—New	......	......	.600 [5]	......	.600	......
Liquid Fuels—Emergency Tax—Expired	......	22.600	......	......	......	22.600
Stock Transfer Tax—Repealed	......	1.100	......	......	......	1.100
Bonus—Repealed	......	.900	......	......	......	.900
Spirituous and Vinous Liquor Taxes—Repealed	......	.040	......	......	......	.040
Shares Tax—Trust Companies—Reduced	......	.600	......	......	......	.600
Capital Stock Tax—Reduced	......	14.960	......	......	......	14.960
Corporate Net Income Tax—Reduced	......	.101	......	......	......	.101
Rural Electric Co-op. Membership Tax—Repealed	......	.005	......	......	......	.005
Net Earnings Tax—Increased	.027	......	......	......	.027	......
Penalties and Interest on Taxes—Decreased	......	.898	......	......	......	.898
Interest Savings—Tax Calendar—Increased	3.000	......	......	......	3.000	......
Liquid Fuels Tax Dedication—Increased	......	11.300 [3]	22.600 [6]	11.300 [5]	......	......
Philadelphia Tax on Mutuals—Repealed	......	......	......	.270 [6]	......	.270
Totals	3.027	86.352	236.326	11.570	182.905	41.474

Analysis of Net Increase in Biennial State-local Tax Revenues

Net Increase in Biennial Local Tax Revenues		224.756
Net Decrease in Biennial State Tax Revenues		
General Fund	71.977	
Motor License Fund	11.348	
		83.325*
Net Increase in Biennial State-Local Tax Revenues		141.431

[1] Unless otherwise noted, amounts are for General Fund. [2] Includes $48 thousand of Motor License Fund receipts. [3] Motor License Fund. [4] School Districts—See Table B, footnote 4. [5] Counties. [6] Municipalities. * Total decrease in state tax revenues.

TABLE D

ANALYSIS OF BIENNIAL REVENUE EFFECTS OF REALLOCATION OF COSTS OF FUNCTIONS AND CHANGES IN GRANTS AMONG THE COMMONWEALTH AND ITS POLITICAL SUBDIVISIONS

(in millions of dollars)

Function [1]	*Commonwealth's General and Motor License Funds* [2]		*Local Revenue*	
	Increase	*Decrease*	*Increase*	*Decrease*
Judicial	....	15.500	15.500 [5]	....
Corrections	....	7.000	7.000 [5]	....
Institutional Welfare	....	22.000	22.000 [5]	....
Public Assistance	32.000	....	....	32.000 [5]
Grant				
State Grants to School Districts from General Fund	119.569 [3]	....	....	119.569 [6]
State Highway Grants to Second Class Townships from Motor License Fund	7.000 [4]	....	....	7.000 [7]
Totals	158.569	44.500	44.500	158.569

[1] The changes in functions involved are:

Judiciary—Transfer of costs of judiciary, minor judiciary, and constables from counties to state (General Fund).

Corrections—All costs for penal offenders in state and semi-state institutions to be transferred from counties to the state (General Fund).

Institutional Welfare—All costs of institutional welfare to be transferred from counties to the state (General Fund).

Public Assistance—Counties to assume about 40 percent of costs of public assistance from state (General Fund).

[2] Unless otherwise noted, amounts are for General Fund.

[3] Includes deficiency appropriations to be made for 1943-1945 grants.

[4] Motor License Fund.

[5] Counties.

[6] Schools.

[7] Municipalities.

It can be observed in Table A that all classes of local political subdivisions of the Commonwealth would show net gains of revenue from the overall proposals, as follows:

Political Subdivision	*Estimated Biennial Net Gain (Based on 1943-1945 State Revenues)* (in millions)
School Districts	$59.6
Counties	35.8
Municipalities (all classes)	15.3
Total	$110.7

The biennial total net gain of $110.7 million in the revenues of the Commonwealth's political subdivisions, which would result from the overall proposals of the Tax Advisory Committee, would permit a substantial and much needed reduction in real estate or other local taxes. In the case of the school districts, under the Tax Advisory Committee's proposals, the Commonwealth would undertake to support a minimum educational standard in all school districts. The Committee further recommends that a part of the increased revenues, assured to the school districts, be available to reduce the school district tax on real estate, and that a mandatory ceiling be placed by the General Assembly upon the taxation of real property for school purposes. The Tax Advisory Committee estimates that, after adequate provision for maintenance of the minimum educational standards, there will be substantial funds, available from the proceeds of the sales tax and other state collected taxes, dedicated to school district purposes, to permit an appreciable reduction in most districts in the school district real estate levy.

Redistribution of the Burden on State and Local Tax Sources

Analysis of the estimated net increase in tax revenues, which would be effected by the recommendations of the Tax Advisory Committee, shows that there would be a substantial redistribution of the overall burden on the several tax sources of state and local governments. The introduction of a broadly-based general retail sales tax, estimated to yield $152 million, biennially, together with the lapsing of the emergency liquid fuels tax, with a revenue loss of $22.6 million, and the repeal of the spirituous and vinous liquor taxes ($40 thousand) would result in a net increase of tax revenues from *general and selected sales* taxes of $129.360 million.

Unincorporated business would contribute $25 million, biennially, under the new tax on net income, whereas it is not now specifically taxed, as such.

Corporation taxes would be reduced by $15.700 million per biennium, as a result of the reduction in the capital stock-franchise tax rate from 5 to 4 mills ($14.8 million) and repeal of the corporation bonus ($900 thousand), while *taxes on specific business* would be increased by $1.169 million. This is the net result of the proposed amendments to taxes on specific business in order to equalize taxation within this group. Taxes on trust companies would actually be decreased by $600 thousand, biennially, while the gross receipts tax on utility companies, both privately and municipally owned, would be increased by $1.478 million, and the various taxes upon insurance companies by $269 thousand. An additional $27 thousand, biennially, of tax revenues from specific businesses would result from extension of the net earnings tax to credit unions and co-operative associations, while $5 thousand would be lost by repeal of the tax on members of rural electric co-operative associations. Other tax revenues would show a biennial net decrease of $500 thousand, as a result of the repeal of the stock transfer tax ($1.1 million) and the taxation of stock of state and federal building and loan and savings and loan associations ($600 thousand).

Finally, and as already noted, there would be a potential reduction of approximately $110.7 million, biennially, in local taxes on real estate or other sources, as a result of revenues, to be made available to the Commonwealth's political subdivisions by the overall effects of the Tax Advisory Committee's plan.

Revenue Effects of the Committee's Tax Plan[1]

The changes in the tax structure, recommended by the Advisory Committee, would result in a determinable net increase of $141.4 million, biennially, in state and local revenues. This increase would come largely from the proposed taxes on general retail sales, yielding $152 million, and on unincorporated business, yielding $25 million, which are estimated to provide a total of $177 million, biennially. The major

[1] See Table C, page 63.

decreases in tax revenue would result from the discontinuance of the General Fund's emergency one-cent tax on liquid fuels ($22.6 million) and from a general rate reduction from 5 mills to 4 mills and certain preferential rates in the capital stock tax. The decrease in biennial revenues from the capital stock tax is estimated at $14.8 million, exclusive of the revenue loss ($16 million), which will follow the restoration of the manufacturers' exemption, as provided for by the 1943 General Assembly.

The entire biennial *gross* increase of $239.4 million in tax revenues, with the exception of $3.027 million for the General Fund, would go to the political subdivisions of the Commonwealth, either by the dedication of state or state-collected taxes to local purposes or by the transfer of taxes or tax subjects from the state to the local level of taxation. The entire biennial *gross* decrease of $97.9 million in tax revenues, with the exception of $11.6 million, lost by counties, would occur in state revenues. Consequently, the biennial net increase in local tax revenues would amount to $224.8 million, without any increase in local levies on the present local tax sources.

The biennial increase in tax revenues would be distributed as follows: school districts, $179.2 million; counties, $23.3 million; and municipalities, $22.3 million. It should be noted that sum of $25 million of revenues (from the proposed unincorporated business tax), which has been treated in the tables as potential county revenue, is recommended by the Tax Advisory Committee for use, first by the counties to help support their share of public assistance costs, with the unused balance distributed among the municipalities. Consequently, the proceeds from the unincorporated business tax would be subject to further legislative allocation between the counties and municipalities.

The Commonwealth's General Fund and its Motor License Fund, on the other hand, would show biennial net losses of tax revenues of $72.0 million and $11.3 million, respectively, or $83.3 million, in aggregate. The reduction in General Fund tax revenues would be the result of transfers of certain revenues to school districts, $24.8 million, and to counties, $9 million; decreased tax revenues, due to rate reductions of $16.6 million; and the loss of tax revenue from repealed taxes, $24.6 million. The General Fund's gross increase in biennial tax revenues would amount to only $3.027 million, compared with a gross decrease of $75.004 million in its tax revenues. In the case of the Motor License Fund, tax revenues would be decreased $11.348 million by reduction of the Motor License Fund's share of the liquid fuels tax from 2½ to 2 cents per gallon ($11.3 million) and by loss of highway use tax revenues, that is, the revenues from the gross receipts tax on interstate motor carriers ($48 thousand).

Revenue Effects of Reallocation of Functions and Grants[1]

The proposed increases or decreases of tax revenue, analyzed above, are only one of two factors, involved in the fiscal effects of the overall program, proposed by the Tax Advisory Committee. Transfers of functions and their costs among the Commonwealth and its political subdivisions and changes in existing state grants would increase the revenue demands upon local governments and decrease their presently available revenues by $114.1 million, biennially, while increasing the total available revenues of the General and Motor License Funds by the same amount.

In detail, school districts would lose $119.6 million in state grants, while counties would assume a share (about 40 percent or $32 million) of public assistance costs, now borne entirely by the General Fund. The resulting increase of $151.6 million in the General Fund's available revenues is partially offset by added costs of functions, transferred from the counties to the state; judiciary—$15.5 million, maintenance of penal offenders in state and semi-state institutions—$7 million, and, institutional welfare—$22 million, an aggregate of $44.5 million. The overall net increase in available revenues of the General Fund, consequently, would be $107.1 million and in those of the counties, $12.5 million. Second class townships would lose grants of $7 million from the Motor License Fund, which, consequently, would have its available revenues increased by the same amount.

In summary, biennial *net* increases in available revenues, resulting from transfers of functions and changes in grants, would amount to $107.1 million for the General Fund and $7 million for the Motor License Fund, a total of $114.1 million for the state, and $12.5 million

[1] See Table D, page 64.

for counties. Net decreases in available revenues, due to loss of state grants, would be $119.6 million for school districts and $7 million for second-class townships (municipalities).

Summary of Revenue and Other Effects of Committee's Proposals

The Tax Advisory Committee's proposals with respect to the reallocation of governmental functions and their costs among the Commonwealth and its political subdivisions, taken in conjunction with those recommendations, affecting tax revenues, would result (in terms of 1943-1945 revenues) in a biennial net increase of $141.4 million in total tax revenues of the Commonwealth and its political subdivisions. Although almost this entire amount would result from changes in, or additions to, state or state-administered taxes, the greatest benefit would accrue to local governments, which would receive increased biennial revenues of $110.7 million, distributed as follows: school districts, $59.6 million; counties, $35.8 million; and municipalities, $15.3 million. The net biennial increase to the state would be $30.7 million, the difference between a net decrease of $4.3 million in Motor License Fund revenues and a net increase of $35.0 million in revenues of the General Fund.

The changes, effected by the Committee's recommendations, would more equitably distribute the burden on state and local tax sources; modernize and rationalize the allocation of governmental functions and their costs among the Commonwealth and its political subdivisions; redetermine and simplify state grants to political subdivisions, particularly to school districts; and permit a substantial reduction in local tax levies.

In the final analysis, the Committee's proposals would increase local biennial revenues by $110.7 million, over and above any added cost to or revenue loss by local governments, consequent to the Committee's recommendations. This amount would be available to the political subdivisions, without increase in their present tax levies, so that it represents the potential reduction in levies on local tax sources, made possible by the overall effects of the Committee's plan. While it is not expected that actual reductions would approximate the potential amount of $110.7 million, the magnitude of that figure assures an ample margin for a substantial reduction in local real estate tax levies, which could be effected without disturbing present standards of services, presently rendered by the Commonwealth's political subdivisions and, in the case of school districts, actually effecting a substantial improvement in present standards.

PART II

THE TAX PLAN

CHAPTER 1

CORPORATE NET INCOME TAX

A tax has been imposed upon the net income of certain corporations in Pennsylvania since 1864.[1] No general corporate net income tax act was enacted, however, until 1923,[2] when an emergency profits tax of one-half of one percent was imposed for two years upon that portion of the net income of all corporations, except building and loan associations, determined to be derived from business transacted in Pennsylvania, by the application of a statutory allocation formula.

In 1935[3] a tax at the rate of 6 percent was imposed for the years 1935 and 1936 upon the net income, derived from Pennsylvania business, of all corporations, doing business in the state, except building and loan associations, banking institutions, and certain insurance companies.[4] Immediately after its passage the constitutionality of this act was upheld.[5]

This act defined the tax base to be net income, as returned to and ascertained by the federal government for federal tax purposes,[6] less any taxes paid to the federal government and excluding any dividends, paid policyholders by insurance companies, doing business on the mutual or participating plan. It also prescribed an allocation formula,

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1 See this Part (II), under "Net Earnings Tax."

2 Act of June 28, 1923, P. L. 876.

3 Act of May 16, 1935, P. L. 208.

4 Section 2 provided: ". . . the word 'corporation' shall not include building and loan associations, banks, bank and trust companies, national banks, savings institutions, trust companies, title insurance companies, beneficial, life and limited life insurance companies, mutual fire, mutual casualty and mutual life insurance companies and foreign stock companies, registered in this Commonwealth and therein engaged in doing business as life, fire and casualty insurance companies, and surety companies."

5 Turco Paint and Varnish Co. v. Kalodner, 320 Pa. 421.

6 This was held not to violate Article III, Section 6, of the Pennsylvania Constitution, which prohibits revival of a law by reference to its title only, since the act did not embody the Act of Congress, providing for an income tax. Commonwealth v. Warner Bros. Theatre, 345 Pa. 270.

hereinafter more fully described, for the ascertainment of that portion of the net income, deemed to be derived from Pennsylvania business, to which the tax rate is applied in computing the tax liability of a corporation, whose entire business is not transacted in this state.

In 1936[7] the rate of the tax was increased to 10 percent and additional deductions were allowed in ascertaining net income on account of any dividends, received from any other corporation.

In 1937[8] the tax was continued for the years 1937 and 1938 at the reduced rate of 7 percent and extensive amendments were made in the procedural and enforcement provisions of the act. The most important substantive amendment was the repeal of the theretofore existing unqualified right of a corporation, owning a majority of stock of another corporation, subject to the act, to make a consolidated report. The 1937 Act provided that the Department of Revenue, in its discretion, could grant the right to make consolidated reports to corporations, making consolidated returns for federal tax purposes.

In 1939[9] the tax was re-enacted for two more years at the rate of 7 percent. This act contained special provision for the allocation of net income of insurance companies.

In 1941[10] the tax was extended at the same rate for the years 1941 and 1942.

In 1943[11] the tax was reimposed for the years 1943 and 1944, but the rate was lowered to 4 percent and at the same time the deductions, previously allowed for federal income and excess profits taxes in ascertaining taxable net income, were eliminated. This act, which is currently in force, prohibited the filing of any consolidated reports whatsoever.

As pointed out above, all corporations are subjected to the tax, except building and loan associations, which have no net income in the usual sense, certain financial institutions, which are subject to specialized and exclusive taxes,[12] and all insurance companies, with the exception of domestic stock companies.

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7 Act of August 7, 1936, P. L. 127.
8 Act of April 8, 1937, P. L. 227.
9 Act of May 5, 1939, P. L. 64.
10 Act of May 29, 1941, P. L. 62.
11 Act of May 7, 1943, P. L. 217.
12 See this Part (II), under "Tax on Shares" and "Net Earnings Tax."

It is exceedingly doubtful whether this form of tax is appropriate for the taxation of any insurance company. As indicated elsewhere in this report, the corporate net income tax is not applied to foreign insurance companies, for they are subjected solely to a 2 percent gross premiums tax. Domestic stock life companies, under present law, are not subject to any gross premiums tax, but are subject to the capital stock and the corporate net income taxes. On the other hand, domestic stock fire and casualty companies are subjected to three taxes, namely, an 8 mill gross premiums tax, the capital stock tax, and the corporate net income tax.[13] Furthermore, in order to allocate to Pennsylvania its proper share of the total net income of an insurance company for taxation, an elaborate formula, different from that, used with respect to other corporations, had to be written into the act.

The application of this formula to the net income, established for federal tax purposes, which is also ascertained by a special formula, has resulted in payment of a surprisingly small amount of tax by the fifty or more domestic stock insurance companies, subject to the act. In 1941 forty-one companies paid taxes of only $23,416.42, in 1942 forty-three companies paid only $49,029.41, and in 1943 forty-one companies paid only $60,666.22. The remainder paid nothing. Under these circumstances it would seem to be desirable to relieve all insurance companies from the corporate net income tax.

The base of the tax on net income is not entirely satisfactory in certain minor respects:

1. The elimination of the deduction, previously allowed for federal income and excess profits taxes, brought the yield of this state tax in more direct relationship to state and national income and in line with practice in other industrial states. This action had the advantage of enhancing the predictability of the tax, because variations in the burden of federal income and excess profits taxes have been extreme in recent years. But, unfortunately, it incidentally eliminated the deduction for federal Declared Value Excess Profits Tax, which is a penalty tax, applicable only under certain conditions. This federal tax is even deductible in calculating other federal taxes and it should be deductible under the Pennsylvania Act.

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[13] See this Part (II), under "Insurance Gross Premiums Tax."

2. Interest, paid on certain federal obligations, is subject to federal tax and is, therefore, returned as net income to the federal government. However, interest on state and municipal obligations is exempt from federal tax and is not so returned, and, consequently, is not subject to the state tax. Thus, the state imposes its corporate net income tax upon the interest of certain federal obligations, but not upon that of state and municipal obligations. This discrimination should be corrected by allowance of the deduction only of interest upon all *federal* securities, not otherwise deducted, especially since a somewhat similar discrimination has been condemned in the field of bank taxation.[14]

3. A corporation may not deduct federal income taxes, paid on behalf of its bondholders, from its federal tax, because the bondholders may credit such payments against their individual income taxes. These payments, however, should be deductible, as expenses, for state tax purposes, because the special reason, underlying the federal rule, does not exist in respect to the state.

4. The federal limitation upon the amount of deduction for capital losses is carried over into the state tax base. Under the federal system the limitation is justified by the imposition of a smaller federal tax burden upon capital gains than upon income. No such justification exists under the state act and, accordingly, the deduction of capital losses should not be limited thereunder. In view of this circumstance, the deduction for net carry over loss from the sale or exchange of capital assets should be disallowed.

5. The state act presently provides machinery for the resettlement of the tax, upward or downward, in the event that net income for federal tax purposes is finally changed or corrected "by the Commissioner of Internal Revenue or by any other agency or court of the United States." This provision of the state law should be broadened to include those cases, where the federal income or excess profits tax is increased or decreased without any change in net income.

Furthermore, doubt has been expressed as to whether this provision contemplates a change (in the actual corporate income, arising from the refund of excessive profits) which results from renegotiation of war contracts, a process, which promises extended duration and con-

[14] See this Part (II), under "Tax on Shares," citing Schuylkill Trust Co. v. Commonwealth, 296 U. S. 113, 302 U. S. 506.

siderable effects on corporation profits. Under such circumstances specific provision should be made for the downward adjustment of the state tax.

6. Where a corporation participates in the filing of a consolidated federal return, it is required to report to the state the net income, which it would have returned to the federal government, had it filed separate returns. That a corporation is compelled to make this speculation is undesirable. The situation should be corrected, however, by amendment of the provisions of the act, dealing with returns, rather than those defining the tax base.

It is suggested that the corporate net income tax report form is unnecessarily detailed and burdensome to prepare. To some extent, this criticism is justified, but the remedy for this lies in administrative regulation and not in amendment to the act. Administrative regulations, therefore, should be brought, and kept, up to date. In one particular, however, the statutory provisions, dealing with the tax report, should be changed.

The prohibition against filing consolidated reports, where one company owns the majority of the stock of another company, both of which are subject to the act, places undue emphasis on individual corporate entities in an affiliated group. In many cases this works a considerable hardship.[15] Under this provision an enterprise, as a whole, may be losing money, but may be subject to a very considerable tax because of the inability to charge the loss of the one company against the gains of the other. Certain businesses find it either desirable or necessary to conduct their affairs by means of a number of separate corporations. They should not be confronted with the alternative of changing their method of operations or of paying an inordinate tax. The act should be amended to permit the filing of consolidated reports by affiliated companies, where such filing is permitted for federal tax purposes. If desirable from an administrative standpoint, there would seem to be no objection to the making of an application for the filing of a consolidated report, but the right to file such a report should be discretionary with the taxpayer rather than with the state.

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[15] *c.f.* National Transit Co. v. Boardman, 328 Pa. 450; Commonwealth v. Lukenweld, Inc., 340 Pa. 401; Commonwealth v. Repplier Coal Co., 53 Dau. 191; Commonwealth v. Pennsylvania Sugar Co., 53 Dau. 230.

Where the entire business of a corporation is not transacted in Pennsylvania, its net income is allocated to the state for taxation by apportionment. Gains from the sales of capital assets, consisting of real estate and tangible property in Pennsylvania, are specifically apportioned to the state for taxation. All other net income is generally apportioned by the application of statutory apportionment fractions.

The specific apportionment, mentioned above, operates inequitably in many instances. Although capital gains, effected in Pennsylvania, are fully taxable, no corresponding deduction in tax is allowed with respect to capital losses, sustained in the state. It has further been suggested that the specific apportionment of gains or losses should not be restricted to those resulting from the sale of real or tangible personal property. Common justice would indicate that it should likewise apply in the case of exchanges of such property. Whether it should also apply in the case of unusual sales or exchanges of intangible property is questionable. Satisfactory application in such case would depend upon a determination of business situs of the property in question. Pennsylvania law on the question of business situs has not yet reached a mature or stable state of development. However, rents and royalties, derived from real or tangible personal property in Pennsylvania and from patents, exclusively used in Pennsylvania, after deducting expenses, could and should be specifically apportioned to this state.

All net income, except capital gains of a corporation (other than insurance companies), whose business is not wholly transacted in Pennsylvania, is generally apportioned by the present act as follows:

> Such net income is divided into three equal parts, allocated to the Commonwealth, as follows:
>
> 1. One part on the ratio of the value of the tangible property, situated in the Commonwealth, to the value of all tangible property.
>
> 2. One part on the ratio of the amount of wages, salaries, commissions, and other compensation, paid to employes, which is assignable to the Commonwealth, to the total amount of such items.
>
> 3. One part on the ratio of the amount of gross receipts from business, which is assignable to the Commonwealth, to the total amount of all gross receipts from business.

Where all three fractions are not applicable, the net income is divided into as many parts as there are applicable fractions. However, a fraction is not inapplicable, where its numerator, but not its denominator, is zero.

All wages, salaries, etc., are assignable to Pennsylvania, except those of employes, "situated at, connected with, or sent out from" premises, maintained by the corporation outside the state.

All sales, fees, and commissions are assignable to Pennsylvania, except those negotiated or effected by agents "situated at, connected with, or sent out from" premises, maintained outside the state.

Rents and royalties from property situated, or patents, used in the state, are assignable to it, as are also all dividends and interest, except those attributable to business, conducted at premises outside the state.

It will be observed that the above general apportionment formula follows that provided for the allocation of the capital stock of a foreign corporation to Pennsylvania for taxation. While in general the formula is satisfactory, in order to correct serious inequities, the gross receipts fraction should be further defined so that the denominator should include only such classes of gross receipts as are considered in the numerator.[16]

In view of the suggestion made above that all domestic stock insurance companies be exempted from the corporate net income tax, it is unnecessary to consider in detail the special allocation formula, prescribed for them by the act. Briefly, their net income is apportioned to Pennsylvania by the ratio of their gross premiums, received from Pennsylvania business, to their total gross premiums.

In the case of railroads and certain other interstate carriers, the third, or gross receipts, fraction is almost impossible to apply, because both passenger fares and freight charges are usually collected in full at the point of origin through to destination, whether the latter be inside or outside the state, and it is not practical to break down the receipts, so collected, between carriage charges in and out of Pennsylvania. The other two fractions, however, present no difficulty. It is, accordingly, suggested that discretionary powers on the part of the

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[16] See Commonwealth v. Eaglis Corporation, 55 Dauphin 356, and Commonwealth v. Rust Engineering Co., 55 Dauphin 434.

taxing officers to accept and apply an equitable equivalent of the gross receipts fraction in each case offer the only possibility of achieving uniformity of result.

In the case of companies, operating on a calendar year, the act requires that the tax be paid one-half on April 15th, the date, upon which tax reports are due, and the other half the following May 15th. A comparable provision is made in the case of companies, filing upon a fiscal year basis. Regardless of the merits of the time for the filing of reports, there seems to be no good reason for payment in two installments. On the other hand, the provision unnecessarily complicates the calculation of interest upon delinquent payments. A provision that in each case the report and payment of tax shall be due five and one-half months after the termination of the period, for which the report is made, would simplify the situation.

The corporate net income tax is unstable, but it is directly responsive to economic changes, and its yield can be predicted within reasonably narrow limits on the basis of national and state income.

Because of this predictability of the yield and, because, of all corporate taxes, the tax on net income is most closely related to "ability to pay," this tax would seem to be a logical selection for the purpose of relieving the present excessive tax burden, imposed by Pennsylvania upon corporate enterprises.[17] Furthermore, the rate of the Pennsylvania tax exceeds that, imposed by comparable tax statutes of most other states. A reduction in the rate would have a desirable effect in encouraging business to locate and expand in Pennsylvania. In any event, as the needs of the Commonwealth vary from time to time, the rate of corporate net income tax could be raised or lowered with reasonably forseeable results.

Recommendations:

1. That the corporate net income tax be made a permanent state tax.

2. That all insurance companies be exempted from the corporate net income tax, which is presently imposed only upon domestic stock fire, marine, casualty, and life companies.

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[17] See Report No. 10 of the Joint State Government Commission, entitled "The Economic Resources and Related Tax Problems of the Commonwealth of Pennsylvania," published January 3, 1945.

3. That in addition to the adjustments, now provided in the act, the basis for imposing the corporate net income tax be adjusted as follows:

(a) That a deduction be allowed for all interest on obligations, issued by the United States or any agency or instrumentality thereof, to the extent that such interest is included in the said basis.

(b) That a deduction be allowed for the net loss from the sale or exchange of capital assets (for the taxable year), which is not included in the said basis.

(c) That the deduction be disallowed for the net carryover loss from the sale or exchange of capital assets, which is included in the said basis.

(d) That a deduction be allowed for the federal tax on tax-free covenant bonds.

(e) That a deduction be allowed for the federal declared value excess profits tax.

4. That an affiliated group of corporations, doing business in Pennsylvania, be given the right to file a consolidated return, if such group has the right to file a consolidated federal return.

5. That income or losses from the following sources be specifically allocated to Pennsylvania or outside of Pennsylvania, depending upon specific locations:

Gains or losses from the sale of tangible personal and real property.
Rents after deduction of expenses.
Royalties from tangible property after deduction of expenses.

6. That the corporate net income tax be amended to include in the numerator of the gross receipts allocation fraction only such classes of gross receipts, attributable to the Commonwealth, as are considered in the denominator.

7. That, where the sale of securities is incidental to the business of the company, the proceeds from such sale be eliminated both from the numerator and denominator of the gross receipts allocation fraction of the corporate net income tax.

8. That change in net income, arising from the refund of excessive profits, which may result from renegotiation of war contracts, be designated in the act as a change, made by an agency of the federal govern-

ment, and that a report of change, giving effect thereto, be filed with the Commonwealth.

9. That the departmental regulations be periodically revised to give effect to all changes, established by legislative amendments and court decisions.

10. That a report of change be required to be filed, where the federal income and/or excess profits taxes have been increased or decreased by the federal government without any change in net income.

11. That to avoid complications, arising from the calculations of interest, the payment of the full tax be required at one time rather than require one-half of the tax on two dates.

12. That in the case of transportation companies the taxing officers be given discretionary powers to accept and apply an equitable equivalent for the gross receipts fraction in order that uniformity of resulting taxation may be achieved from the general formula for allocation of business, transacted within the state.

TAX YIELDS OF THE CORPORATE NET INCOME TAX—1935-1943

The biennial collections from the corporate net income tax are presented in the following table for the four biennia, 1935-1943. Major variations in yields of the tax during this period resulted from changes in economic conditions and from changes in the rates, which were 6 percent on corporate net income for the taxable year,[18] 1935, 10 percent for the taxable year, 1936, and 7 percent for the taxable years, 1937-1942, inclusive. At the 7 percent rate, biennial collections increased from $44.5 million in 1937-1939 to $90.6 million in 1941-1943, and from 10.8 percent of the Commonwealth's total tax collections in the earlier biennium to 19.4 percent of the total in the 1941-1943 biennium.

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Average State Income* (in millions)
1935-1937	$42,843	11.5	$5,046
1937-1939	44,533	10.8	5,416
1939-1941	53,344	12.8	6,052
1941-1943	90,621	19.4	8,075
1943-1945[1]	129,217	30.3	10,076

[1] Actual and estimated.

[18] The calendar year or corporate fiscal years, ending in that calendar year.

The tremendous growth in corporate net income tax receipts, evidenced in the above table, can be directly correlated with the state income.[19] If the actual yield of each year's tax, regardless of the date of collection, is related to the state income for the taxable year, the following correlation is established for the years 1935-1941, inclusive, the only years for which reasonably accurate and complete data are presently available.

Year [1]	*Tax Rate*	*Total Yield* (in thousands)	*Yield at 1%* (in thousands)	*State Income* (in millions)	*Yield* (in thousands) *at 1% Rate for Each Billion of State Income*
1935	6	$16,905	$2,818	$4,974	$56.6
1936	10	34,128	3,413	5,808	58.8
1937	7	27,934	3,991	6,173	64.6
1938	7	15,534	2,219	5,441	40.8
1939	7	23,065	3,295	5,829	56.5
1940	7	28,889	4,111	6,291	65.4
1941	7	41,690	5,956	7,542	79.0

[1] Calendar and taxable year.

From 1936 to 1940, inclusive, the effect of changes in federal corporate tax laws was less severe upon the state corporate net income tax base than in subsequent years, and a remarkable consistency in yields prevailed. However, when federal war profits taxation became effective in 1941, the state corporate net income tax base was greatly altered.

The high degree of correlation of the yields of the corporate net income tax with state income can be demonstrated by using 1938 (the low year in the selected period for both state income and the corporate net income tax yield) as a base for the years, 1936-1940, inclusive, and measuring the relation of tax yields and state income in excess of the amounts for the basic year. The pertinent data are presented in the following table:

Year	*State Income Excess Over Base—1938*	*Tax Yield Excess Over Base—1938*	*Increase in Tax Yield, at 1% Rate, for Each $100 Million in Excess of 1938 Income*
	(in millions)	(in thousands)	(in thousands)
1936	$367	$1,193.8	$325
1937	732	1,770.5	242
1938	(Base=5,441)	(Base=2,219)	....
1939	388	1,076.0	277
1940	850	1,892.3	223

[19] Income payments to individuals, by states, as reported by U. S. Department of Commerce.

The above table clearly demonstrates that in the period, 1936-1940, inclusive, and especially 1937-1940, each $100 million of state income in excess of the 1938 base was accompanied by an additional tax yield of about $250 thousand for each 1 percent of the tax rate. Although complete data are not yet available for 1941 and 1942 as to the effect of federal corporate tax changes on the state base, and for the years, 1943 and 1944, which will be on a different base, because of the 1943 amendments, it appears reasonable to expect that a relation can be established between the yields from the old and new bases, so that the taxing authorities, after further experience with the corporate net income tax, will be able to estimate the revenues from the tax with a high degree of accuracy. Furthermore, the elimination of the deduction for federal income and excess profits taxes from the tax base should do much to eliminate the extreme variations, already remarked in connection with the 1938, 1941, and 1942 yields of the tax.

CHAPTER 2

CAPITAL STOCK AND FRANCHISE TAX

The capital stock of corporations was first subjected to tax in Pennsylvania in 1840,[1] when a tax of one-half mill for each one percent of dividend was imposed upon shares of stock. Although this act measured the tax by the dividend, it was held to be a tax on the capital stock of the corporation.[2]

The capital stock tax, as it exists today, however, first began to take form in 1844,[3] when an annual tax of one-half mill for each one percent of dividend was imposed upon the par value of the stock of companies, declaring dividends of 6 percent or more, provided that, in the case of companies, paying either no dividend or one less than 6 percent, the tax should be three mills upon the appraised value of the stock. This act applied only to domestic companies.

In 1868[4] the capital stock tax was extended to foreign corporations, doing business in the state, while banks and savings institutions, as well as foreign insurance companies, were exempted from the tax. In 1868,[5] also, it was specifically provided that shares of stock of a corporation, liable to the capital stock tax, should not be taxed in the hands of the stockholder for state, county, or local purposes.

In 1874[6] the officers of taxable companies were required to appraise the capital stock of their companies for tax purposes at not less than its average selling price.

In the 1879[7] compilation of the state's revenue laws, the tax was extended to limited partnerships, except those, organized for manufacturing[8] and mercantile purposes, and two minimum standards for appraisement of the capital stock were established. These were the average

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[1] Act of June 11, 1840, P. L. 612.

[2] Commonwealth v. Pennsylvania Insurance Co., 13 Pa. 165.

[3] Act of April 29, 1844, P. L. 486, by which act, also somewhat appropriately, the Pennsylvania Railroad was incorporated.

[4] Act of May 1, 1868, P. L. 108.

[5] Act of January 3, 1868, P. L. 1318, c.f. this Part (II) under, "Personal Property Tax, Corporate and Municipal Loans Taxes."

[6] Act of April 24, 1874, P. L. 68.

[7] Act of June 7, 1879, P. L. 112.

[8] This seems to be the first suggestion of a "manufacturing exemption" in the state laws.

selling price of the stock and the value, indicated by the dividends, "made or declared."

In 1885 [9] the "manufacturing exemption" was first enacted in the form of abolition of taxes, laid "upon manufacturing companies" by the revenue laws of the state. The exemption, however, did not apply to manufacturers of liquors and gas. The constitutionality of this exemption and the exception to it was sustained.[10]

What constitutes "manufacturing" has been the subject of innumerable decisions in Pennsylvania during the 50 years (1885-1935), in which the "manufacturing exemption" was in effect. The mere fact that labor, however skilled, is expended with respect to a commodity, before it is marketed, has been held not to be enough; a new article must be fabricated, and the original materials, upon which labor is expended, must thereby be changed or brought into new combinations, so as to adapt them to new and different uses.[11]

In the 1889[12] codification of the state's revenue laws, the manufacturing exemption was limited to companies, "organized exclusively for manufacturing," except brewing and distilling companies. This language led to the absurd result that a company, having a non-manufacturing purpose in its charter, was denied the exemption, even though, under other charter powers, it engaged exclusively in manufacturing.[13] This act made no change in the rate or base of the tax and retained the two minimum standards of appraisement, set up in the 1879 act. It did, however, declare that the "dividend" standard should include undivided profits, as well as dividends actually paid.

In 1891[14] the rate of the tax was established at 5 mills, irrespective of the payment of dividends. The terms of the manufacturing exemption, however, remained unaltered and the minimum standards of valuation were essentially unchanged. This act also separately classified fire and marine insurance companies and imposed a 3 mill rate upon their capital stock.

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9 Act of June 30, 1885, P. L. 193.
10 Commonwealth v. Germania Brewing Co., 145 Pa. 83.
11 Commonwealth v. Sunbeam Water Co., 284 Pa. 180; Commonwealth v. Boyer Plumbing & Heating Co., 49 C. C. 610.
12 Act of June 1, 1889, P. L. 420.
13 Commonwealth v. Westinghouse Electric Manufacturing Company, 151 Pa. 265.
14 Act of June 8, 1891, P. L. 229.

In 1893[15] the final, and, until 1935, the permanent language of the manufacturing exemption was evolved. The act of that year exempted that portion of the capital of companies,

> "organized for manufacturing purposes, which is invested and actually and exclusively employed in carrying on manufacturing * * * excepting companies engaged in the brewing or distilling of spirits or malt liquors, and such as enjoy and exercise the right of eminent domain."

Under this language, capital engaged in the manufacture of gas, was exempted from the tax,[16] although, as noted above, gas companies did not originally share in the exemption and in many instances exercised the power of eminent domain. In the case cited this latter consideration was not discussed.

In 1913[17] capital, employed in laundering, and in 1929[18] capital, employed in the "processing and curing of meats," was likewise exempted from the tax. The Courts had previously held that these activities did not constitute manufacturing.

In 1897[19] companies, organized and incorporated for the purpose of distilling and selling liquors,[20] were subjected to a 10 mill capital stock tax. The contrast between the phraseology, establishing this classification, and of the manufacturing exemption, should be noted.

In 1911 [21] building and loan associations were exempted from the tax. First class or non-profit corporations, as well as co-operative agricultural corporations, without capital stock, were not exempted until 1927.[22] In view of the recent holding of the Attorney General that all co-operative agriculture associations, including those with capital stock, are subject to the net earnings tax, and the recommendation, made elsewhere in this report, that certain co-operative associations be subjected to the gross receipts tax, there seems to be no good reason why all co-operative associations should not be exempted from the

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15 Act of June 8, 1893, P. L. 353.
16 Commonwealth v. Swindell and Bros. Co., 22 Dau. 184.
17 Act of July 22, 1913, P. L. 903.
18 Act of April 25, 1929, P. L. 657.
19 Act of July 15, 1897, P. L. 292.
20 Held to be applicable to a company so organized even if it was not actually distilling or selling liquor. Commonwealth v. David Berg Distilling Co., 23 Dau. 275; Commonwealth v. John McGlinn Distilling Co., 265 Pa. 346.
21 Act of June 7, 1911, P. L. 673.
22 Act of May 4, 1927, P. L. 742.

capital stock-franchise tax. Banking institutions, subjected to a tax on shares, had been theretofore exempted from the capital stock tax.[23]

In 1915[24] the standards for the appraisement of the capital stock were finally expressed in their present form. The act of that year provided that the stock should be appraised:

> "at its actual value in cash as it existed at the close of the year for which report is made; not less, however, than, first, the average price which said stock sold for during the year; and second, not less than the price or value indicated or measured by net earnings or by the amount of profit made, and either declared in dividends, expended in betterments, or carried into surplus or sinking fund; and third, not less than the actual value indicated or measured by consideration of the intrinsic value of its tangible property and assets, and of its good will and franchises and privileges as indicated by the material results of their exercise, taking also into consideration the amounts of its indebtedness."

The provisions of the section have never been literally followed in practice. The Courts have held that the actual value of the capital stock is a question of fact to be resolved by the exercise of sound discretion and by considering all relevant factors.[25] This anomalous situation, however, has provoked many well-founded criticisms of the language, quoted above, especially of the words "not less, however, than." It is asserted that these words are misleading and prejudicial to small domestic corporations and to corporations, accountants, and attorneys outside the state, especially since the capital stock tax has been made self-assessing. It is also claimed that they might deter companies from coming into the state for tax reasons and that they make the taxing practice subject to capricious change on the part of the taxing officers, despite the long line of decisions on the subject. On the other hand, amendment of this language has long been resisted, because of the fear that any alteration in the statutory wording (which is asserted to be innocuous) would unsettle numerous judicial decisions and thus would be provocative of litigation. It is felt that the objections to the language in question could be largely met without unsettling the decisional

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23 See this Part (II), under "Tax on Shares of Banking Institutions."
24 Act of June 2, 1915, P. L. 730.
25 Commonwealth v. Edgerton Coal Co., 164 Pa. 284; Commonwealth v. Pomeroy's, Inc., 344 Pa. 538.

law by appropriate changes in the valuation affidavit on the report or some similar recognition of the decisions elsewhere in the report form.

In arriving at the valuation of the capital stock of a corporation for tax purposes, certain of its assets are non-taxable because the tax is imposed upon property.[26] Accordingly, that portion of the capital, invested in federal securities,[27] in inventories of imported merchandise in the original packages,[28] and tangible property beyond the jurisdiction of the state,[29] has been held to be exempted from tax.

Certain holdings of stock of other corporations also have been held to be "non-taxable" assets on the grounds that there would otherwise result a duplication in taxation. Thus, shares of stock of another company, subject to the capital stock tax, have been held to be non-taxable assets.[30]

Holdings of stock of foreign corporations, not liable to the capital stock tax, however, were held to be taxable,[31] because such holdings are intangible property. This ruling had certain inequitable aspects and it was legislatively changed in 1927,[32] when it was provided that so much of the investment in shares of an auxiliary company, as represented property outside the state, should be exempted. This act was almost impossible of application and it was superseded in 1931[33] by a statute, providing that, where a domestic company shall own the majority of the shares of another company, so much thereof, as represents property outside the state, should be exempted.

The method, by which the exemption of non-taxable assets should be made effective, was determined by apportioning the value of the capital stock according to the ratio, which the whole taxable assets bore to the total assets of the corporation,[34] and this decision was reduced to statutory form in 1931.[35]

In 1935,[36] as a part of the emergency tax program of that year,

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26 Commonwealth v. Standard Oil Co., 101 Pa. 119.
27 Commonwealth v. Lackawanna Iron & Coal Co., 129 Pa. 346.
28 Brown v. Maryland, 25 U. S. 419; Cook v. Pennsylvania, 97 U. S. 566.
29 D. L. & W. R. R. Co. v. Pennsylvania, 198 U. S. 341.
30 Commonwealth v. Shenango Furnace Co., 268 Pa. 283.
31 Commonwealth v. Sunbury Converting Works, 286 Pa. 545.
32 Act of April 20, 1927, P. L. 311.
33 Act of June 22, 1931, P. L. 687.
34 Commonwealth v. Union Shipbuilding Co., 271 Pa. 403.
35 Act of June 22, 1931, P. L. 685.
36 Act of May 16, 1935, P. L. 184.

foreign corporations, doing business in Pennsylvania, were subjected to a franchise tax in lieu[37] of a capital stock tax. The franchise tax was imposed by means of amendments to the Capital Stock Tax Act, thus emphasizing the close relationship between the two taxes. This tax, like the capital stock tax, used as its underlying element, the value of the entire capital stock of the company, but allocated that value to Pennsylvania for taxation by the use of fractions, similar to those prescribed in the simultaneously enacted corporate net income tax for the general apportionment of income. The details of this allocation formula are discussed elsewhere[38] and will not be repeated here.

The most important result of the tax was to impose upon foreign corporations a more equitable proportion of the burden of taxation. As was said in Commonwealth v. Columbia Gas & Electric Co., 336 Pa. 209, in which the constitutionality of the tax was upheld:

> "* * * it became the practice to tax only so much of the capital stock of a foreign corporation as the ratio of tangible assets in the state bore to all assets of the foreign corporations wherever situated. Under this arrangement foreign corporations, transacting a large part of their business here, escaped their fair share of the tax burden. The assets of foreign corporations, so far as they were comprised of intangibles, were wholly free of tax notwithstanding that they may have played an important part in the conduct of the company's local business. The old tax did not even reach all the tangible property of the enterprise located in this state. It made no attempt to value foreign corporations either as going concerns within this state, or as parts of going concerns which the foreign corporations had created through operations in this and other states. The discrimination under the old tax law was not only unfair, but operated unjustly in favor of foreign corporations and against domestic corporations, even though they might be similarly situated. * * *"

By the same 1935 act the exemption of capital, employed in manufacturing (except that of companies engaged in the distilling of liquors and those enjoying the right of eminent domain), laundering, and the processing of meats was repealed for a two year period. In 1937[39] this repeal was made permanent. However, in 1943[40] an act was passed,

[37] Arrott's Estate, 322 Pa. 367.
[38] See this Part (II), under "Corporate Net Income Tax."
[39] Act of April 8, 1937, P. L. 239.
[40] Act of May 27, 1943, P. L. 762.

restoring the manufacturing exemption on January 1, 1945, or the first day of the year following the date of the cessation of hostilities in the present war, whichever is later. The act also provided for the allocation to Pennsylvania, for taxation, of the capital stock of those foreign companies, not wholly engaged in manufacturing, by excluding the Pennsylvania assets, wages, and gross receipts, employed in or resulting from manufacturing, from the numerators of the allocation fractions.

The substitution of the franchise tax for the capital stock tax in the case of foreign companies materially increased the revenues of the state, but, although the figure has been variously estimated, the large number of factors involved makes any estimate unreliable. The elimination of the manufacturing exemption was estimated to increase revenues further from $15,000,000 to $20,000,000 per biennium, with the probabilities favoring the lower figure.

With respect to the allocation formula, the same criticisms, expressed in the section dealing with corporate net income tax, are applicable here. The two formulae should be brought into conformity and the wages and gross receipts, allocated to Pennsylvania, as used in the second and third fractions, should be determined in a way more nearly approximating actualities. Here also discretion should be given the taxing officers to accept and apply equitable equivalents of the gross receipts fraction in the case of transportation companies.

As stated above, the fundamental base of the franchise tax is the same as the capital stock tax, namely, the value of the capital stock of the company. However, since the capital stock tax is a property tax,[41] and the franchise tax is not,[42] the assets, held to be non-taxable for capital stock tax purposes (discussed above), are not necessarily exempted for franchise tax purposes.

In order that the bases of the two taxes shall coincide, therefore, it would seem desirable, specifically, to extend to the ascertainment of the franchise tax base the provisions of the 1931 act, exempting shares of subsidiaries more than 50 percent owned.[43]

It would likewise seem to be desirable to exempt the value of

[41] Commonwealth v. Standard Oil Co., *supra;* Commonwealth v. Sykes, 53 Dau. 26.
[42] Commonwealth v. Quaker Oats Co., 52 Dau. 406, 350 Pa. 253.
[43] See footnote 33 *supra.*

United States securities, national bank shares, and inventories of imported merchandise in the original packages[44] in the ascertainment of the franchise tax base.

Furthermore, the formula of the 1931[45] act, for computing the exemption of non-taxable assets, not applicable to the capital stock tax, should be extended to the franchise tax.

The literal application of the statutory allocation fraction, as might be expected from any arbitrary mathematical formula, sometimes results in inequitable, and even absurd, results, both in the cases of the franchise and the corporate net income tax. Although the courts have generally approved the fairness of the formula, they have indicated that adjustments must be made to avoid inequities in certain unusual cases.[46] In other states, having somewhat similar taxing statutes, specific statutory authority is vested in the taxing officers to adopt alternative methods of taxation, where the application of the statutory formula produces inequitable results.

A similar provision in Pennsylvania, however, would seem to be undesirable. It would inevitably lead to the exertion of improper pressure on the taxing authorities in certain cases; it would delay the settlement of accounts, which, in view of the self-assessing provision, would result in undue accumulations of interest; and, because of the numerous taxing personnel, required in this state, it might bring about inconsistencies in taxing practice, that would contravene the strictly construed uniformity clause of the Pennsylvania Constitution.[47] Furthermore, the power to make equitable adjustments now exists and is vested by law in the Board of Finance and Revenue.[48] By leaving this power where it now is, the danger of the invidious results, outlined above, will be greatly minimized. In the past, the Board has not always been as diligent as it might have been to exercise its equitable powers. This, however, is not a matter for legislative enactment; it is a matter of administration.

The capital stock-franchise tax has long been considered the back-

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44 See footnotes 27, 28, and 29 *supra*.

45 See footnote 35 *supra*. Judicially suggested in Baxter, Kelly & Faust, Inc., 53 Dau. 73.

46 Commonwealth v. Columbia Gas & Electric Co., 336 Pa., 209; Turco Paint & Varnish Co. v. Kalodner, 320 Pa. 421.

47 Article IX, Section 1.

48 Sections 1103 and 503 of The Fiscal Code (Act of April 9, 1929, P. L. 343).

bone of Pennsylvania's tax system. Prior to 1941, it produced a greater share of the general revenues of the state than any other tax; and this was true even after the exceedingly productive consumption taxes on liquors, beer, and cigarettes, as well as the corporate net income tax, were enacted. In the 1941-1943 biennium, however, the capital stock-franchise tax, as a revenue producer, yielded first place to the corporate net income tax.

Furthermore, since the tax is imposed upon capital, it reacts sluggishly to economic conditions. As a principal component of the state's tax system, this relative stability has great advantages, but this very stability makes it especially onerous upon corporations, because, by the same token, its burden does not vary with ability to pay.

As has been demonstrated elsewhere in this report, the burden of taxation upon corporate enterprise in Pennsylvania is disproportionately heavy. The manufacturing exemption was, in part, a recognition of this fact. In addition, the manufacturing exemption implemented a policy to encourage manufacturing in the state and thus promoted the utilization of Pennsylvania's peculiarly appropriate resources of labor and raw materials to the advantage of its citizens.

The present flourishing condition of the state's finances makes possible the amelioration of the excessive tax burden on corporate enterprise. There are, however, conflicting ideas as to what form this relief shall take. On the one hand, it is suggested that the relief should be horizontal and that the capital stock-franchise tax should be reduced generally from 5 to 4 mills. On the other, it is advocated that the manufacturing exemption be immediately restored, that the preferential rate, heretofore enjoyed by domestic stock fire and marine insurance companies because of their unfavorable competitive situation, be reinstated, and that recognition be given of the equally unfavorable competitive situation of the coal mining and the oil extraction industry by the application of a preferential rate to capital so employed.

The manufacturng exemption has strong claims to primary consideration. It was in force during the fifty years, which saw the development of Pennsylvania's industrial pre-eminence. Furthermore, it is the subject of a "promissory note," of reasonable certainty though indefinite maturity, now on the statute books. If it be asserted that the manufacturing exemption is inconsistent with the theory that all enterprise should bear a share of the tax burden, a partial answer is to be found in the corporate net income tax, the bulk of which is paid by corporations, engaged in manufacturing.

Elsewhere in this report it has been shown that domestic stock fire and marine insurance companies have an excellent case for relief, in the form of a reduction of this tax from 5 to 2 mills.[49]

An even stronger case can be made out for companies, engaged in coal mining. Coal has always been and still is a major industry in Pennsylvania, directly employing thousands of her citizens and indirectly supporting a large part of her economic structure. In 1940, 91,041 anthracite workers and 117,832 bituminous workers were employed by the industry. Bituminous coal is mined in 28 counties, where 39.5 percent of the population of the state resides. Anthracite mining is concentrated in 8 counties, but the population of this area is 14.4 percent of that of the state. While the dependence of the area, in which bituminous coal is mined, varies, it is, nevertheless, substantial. The 8 anthracite counties, however, depend chiefly on mining, as there is little other industry in this area.

Although coal *mines,* in contrast to manufacturing plants, cannot move from the state to escape adverse economic or tax conditions, the *production* of coal can, and does, gravitate to localities, where favorable conditions prevail. Furthermore, coal has to meet the competition of other fuels, of which the principal one, oil, has received the equivalent of a federal subsidy in the form of the "Big and Little Inch" pipe lines.[50]

It is a matter of common knowledge that Pennsylvania's bituminous production has lost considerable volume to other states. The decline in the Pennsylvania anthracite industry is even worse and is more susceptible of demonstration, because all anthracite is in Pennsylvania.

The coal industry, as a whole, is worse off than any other major industry. In the bituminous industry a net profit per ton was realized in only two of the last twelve years, amounting to $.008 in 1940 and

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[49] See this Part (II), under "Insurance Gross Premiums Taxes."

[50] These lines cost $139,000,000 and are transporting oil into the national market for Pennsylvania coal at a rate equivalent to more than 116,000 coal tons per day. Anthracite production of deep-mined coal for the four months to December 31, 1943, averaged 108,733 tons per day.

$.037 in 1941. The annual average loss per ton from 1936 to 1941, inclusive, was $.056. In the anthracite industry there was a profit per ton of $.105 in 1930 and $.062 in 1941. The average loss for the period was $.197 per ton and in 1938 a loss of $.549 per ton was sustained. Even more significant is the fact that the total assets of the anthracite industry, as of December 1, 1931, were $798,338,000, whereas on December 31, 1941, they were $372,000,000, *a decline of 53 percent, all of which occurred in Pennsylvania.* In 1931 anthracite sold for an average of $5.35 per ton, shipped, while labor costs represent two-thirds of the cost of production. In 1943 this coal sold for $5.38 per ton, but there had been an increase in hourly wages of 29.6 percent. By 1944, hourly earnings had increased to 145 percent of those paid in 1931.

Meanwhile, state and local taxes, paid by the anthracite industry, decreased from $14,631,000 in 1931 to $12,974,000 in 1934 and to $11,533,000 in 1941. Although taxes declined, despite the imposition of the corporate net income tax in 1935, which obviously was not an important factor in an unprofitable industry, this decline in taxes was by no means commensurate with the decline in production and profits in the industry.

Considering that such a large segment of the state's population depends on the coal industry, that the industry is faced with severe competition from without the state and from competing fuels, and that it is in serious financial difficulties, despite its ability thus far to maintain a fair wage schedule, it is apparent that the state, as a matter of policy, should give this industry all possible help. It is, accordingly, recommended that a preferential capital stock tax rate of 2 mills be applied to capital, actually and exclusively engaged in the mining of coal. A similar case can be made out for the oil extraction industry in Pennsylvania, which exploits one of the state's natural resources at a distinct competitive disadvantage with the same activity in other states.

Recognition (1) of the special claims of the four industries, just discussed, to preferential tax treatment, and (2) of the fact that all corporate enterprise is relatively too heavily tax-burdened in Pennsylvania, is within the realm of possibility, although, of course, it is dependent upon a careful correlation with the state's budgetary requirements. Subject to the precise ascertainment of the state's immediate future needs, it is recommended that the capital stock-franchise tax rate be reduced generally to 4 mills, that capital, actually and exclusively engaged in coal mining and oil extraction, and the capital of domestic stock fire and marine insurance companies be taxed at the reduced rate of 2 mills, that the prospective exemption of manufacturing capital be undisturbed, and that the 10 mill rate upon the capital of corporations, organized for distilling and selling liquor, be retained.

The receipts, derived from the capital stock-franchise tax in the 1941-1943 biennium, were approximately $70,000,000. A flat reduction of 1 mill in the tax rate would, therefore, amount to $14,000,000, of which $3,000,000[51] would represent the reduction of tax on manufacturing capital. If the exemption of manufacturing capital were restored, an additional reduction in receipts of $12,000,000 would result. The further reduction in revenue, resulting from the taxation of mining and oil extraction capital at 2 mills, would not be large, although exact figures are not available. The reduction of the tax rate on fire and marine insurance companies would involve an inconsequential amount. A conservative estimate of the total reduction in revenue, resulting from the plan outlined above, based on 1941-1943 yields, would be approximately $25,000,000.

It has been suggested that the method of effectuating the manufacturers' exemption in the case of foreign companies, as set forth in the 1943 act, leads to insoluble difficulties in the case of the gross receipts fraction. It is obviously difficult in all, and impossible in some, cases to identify the gross receipts, exclusively derived from manufacturing. The attribution of those gross receipts to Pennsylvania and elsewhere only adds to the complexity of the situation. In lieu of the allocation formula, prescribed in the 1943 act, it is recommended that the capital of a foreign company, engaged in manufacturing, mining, and oil extraction, be allocated to Pennsylvania, as in the case of any other foreign company. It is also recommended that the portion of the Pennsylvania capital, engaged in these industries, be ascertained by applying thereto a fraction, the numerator of which shall consist of the tangible property, employed in such industries in Pennsylvania, and the denominator of which shall consist of all the tangible property of

[51] On the basis of the manufacturing exemption amounting to a $15,000,000 reduction in tax.

the company in Pennsylvania. The latter will, of course, be the same as the numerator of the first general allocation fraction. Although this proposal is susceptible of obvious refinements, they would add to its complexity. It is felt that the recommended method will have the virtues of simplicity and ease of application and that it will be substantially equitable.

Recommendations:

1. That the capital stock-franchise tax be retained as a state tax.

2. That all co-operative associations, including those with capital stock be exempted from the tax.

3. That the valuation affidavit on the capital stock tax form be changed to take cognizance of court decisions on the capital stock and franchise tax, or that such information be otherwise shown on the return for the benefit of taxpayers, not familiar with the court decisions on valuation.

4. (a) That the allocation formula of the franchise tax be brought into conformity with that, provided in the case of the corporate net income tax; (b) That both the valuation affidavit and the allocation formula be amended so that wages, attributed to Pennsylvania, shall more closely approximate those earned by employes, chiefly doing their work in Pennsylvania, and so that gross receipts, so attributed, shall more nearly approximate the gross receipts from Pennsylvania business.

5. That in the case of foreign transportation companies, subject to the franchise tax, the taxing officers be given discretionary powers to accept and apply an equitable equivalent for the gross receipts fraction in order that uniformity of resulting taxation may be achieved.

6. That the value of shares of subsidiary corporations, held to an extent greater than 50 percent of the outstanding voting stock, be exempted in ascertaining the tax base for franchise tax purposes, as it now is for capital stock tax purposes.

7. That the value of United States securities, national bank shares, and inventories of imported merchandise in the original packages be exempted in ascertaining the tax base for franchise tax purposes.

8. That the formula of the Act of 1931, P. L. 685, for computing the exemption of non-taxable assets in ascertaining the tax base for

capital stock tax purposes be made applicable in the case of the franchise tax.

9. That the prospective exemption of manufacturing capital from the capital stock-franchise tax be undisturbed.

10. That the capital stock-franchise tax rate be reduced to four mills.

11. That a preferential rate of not more than two mills be applied to capital, engaged in coal mining and oil extraction in Pennsylvania, and to the capital of domestic stock fire and marine insurance companies.

12. That the portion of the capital of a foreign corporation, engaged in manufacturing, mining, and oil extraction in Pennsylvania be ascertained by applying to the capital, allocated to Pennsylvania, through the operation of the present statutory formula, a fraction, the numerator of which is the tangible property, employed in manufacturing, coal mining, and oil extraction in the state, and the denominator of which is the total tangible property, located in the state.

13. That the present method of valuing the capital stock of domestic insurance companies for capital stock tax purposes and the present coverage of the tax be undisturbed.

BIENNIAL TAX COLLECTIONS
CAPITAL STOCK TAX AND FOREIGN FRANCHISE TAX

	Amount (in thousands)				
	Capital Stock	*Foreign Franchise*	*Total*	*Percent of Total Taxes*	*Average State Income (in millions)*
1923-1925	(Combined)		$35,928	26.0	$6,149
1925-1927	(Combined)		39,584	24.8	6,356
1927-1929	(Combined)		38,427	20.5	6,587
1929-1931	$41,264	$2,299	43,563	17.9	6,775
1931-1933	38,636	1,937	40,573	18.5	4,773
1933-1935	31,499	2,030	33,529	17.1	4,216
1935-1937	53,053	12,017	65,070	17.4	5,046
1937-1939	41,937	15,524	57,461	13.9	5,416
1939-1941	43,031	13,943	56,974	13.7	6,052
1941-1943	49,436	21,352	70,788	15.1	8,075
1943-1945 [1]	47,919	19,021	66,940	14.5	10,076

[1] Actual and estimated.

From 1923 to 1935 the capital stock tax yields show a general correlation with state income, despite a slight deviation in 1927-1929. Direct correlation, however, cannot be established, because capital stock tax receipts have shown greater than average increases in times of increasing state income and less than average decreases, when state income declined. For example, capital stock tax receipts increased 21.3 percent from 1923-1925 to 1929-1931 and decreased 23.0 percent between the latter biennium and 1933-1935. In the same periods, state income increased 10.2 percent and decreased 37.8 percent. From 1923 to 1935 the capital stock tax was the General Fund's largest and most reliable revenue producer, despite growth of the inheritance tax, which surpassed it in 1929-1933.

The change in the taxation of foreign corporations to a franchise base and the suspension of the manufacturers' exemption in 1935, as an emergency measure, increased biennial collections from this tax by an estimated $20 million. If this amount is deducted from biennial collections from 1935 to 1943, it is evident that they have been very stable, revealing much the same pattern as in the 1923-1931 period.

On the whole, the capital stock tax possesses highly desirable revenue characteristics, responding generally and moderately to increases in state and national income, while exhibiting great stability and a relatively slow rate of revenue decrease in periods of economic decline. Revenues, therefore, are predictable with reasonable accuracy, but not within narrow limits, feasible for the corporate net income tax.

CHAPTER 3

NET EARNINGS TAX

The net earnings tax was first imposed upon certain corporations in 1864.[1] This act also imposed the tax upon private bankers and brokers as an alternative to the gross receipts tax, then in force.[2] So far as its application to corporations was concerned, the net earnings tax was originally designated as a "catch-all" tax, that is to say, it was devised to tax all corporations, not otherwise taxed. Thus, in 1864 the tax was imposed upon all corporations, not paying a tax upon dividends or tonnage.[3] Even in those days the corporations, subject to the net earnings tax, were limited in number, because most corporations were liable to pay a tax on dividends.[4]

The tax has retained its character as a "catch-all" tax ever since it was first imposed. Thus, in the 1879[5] tax codification it was imposed upon those corporations, not liable under the same act to a capital stock or gross receipts tax. In the 1889[6] codification, the tax, which, as noted, theretofore applied to certain corporations and individuals, was restricted to those corporations, not subject to the taxes, imposed by the 21st[7] or 24th[8] sections of that act. The tax is still imposed under the provisions of the Act of 1889.

As a practical matter, the only corporations, subject to the tax from 1889 to 1943, seem to have been savings institutions without capital stock. However, in 1943[9] the Attorney General ruled that it likewise applied to co-operative agricultural corporations, having capital stock,[10] co-operative credit associations,[11] and co-operative agricultural corporations without capital stock.[12] By application of the same reasoning, it would seem that domestic mutual insurance companies should likewise be subject to the tax, because they are not taxed under

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1 Act of April 30, 1864, P. L. 218.
2 See this Part (II), under "Private Bankers Gross Receipts Tax."
3 Imposed upon certain transportation companies before the advent of the utilities gross receipts tax.
4 Act of April 29, 1844, P. L. 486.
5 Act of June 7, 1879, P. L. 112 (Section 10).
6 Section 27, Act of June 1, 1889, P. L. 420.
7 The capital stock tax.
8 The gross premiums tax.
9 Formal Opinion No. 461, June 28, 1943.
10 Formed under the Act of May 1, 1929, P. L. 1201.
11 Formed under the Act of May 26, 1933, P. L. 1076.
12 Formed under the Act of June 12, 1919, P. L. 466.

the 21st or 24th Sections of the Act of 1889. The act, however, has not been so administered by the taxing authorities of the state. Domestic mutual insurance companies should be specifically exempted from this tax for reasons, stated in the discussions of the insurance gross premiums tax.

Building and loan associations also would seem to be subject to the tax, although it has never been collected from them. These corporations are not presently liable to either a capital stock or gross premiums tax. Prior to 1937 they were liable to a tax on their fully paid shares but, unlike the tax on shares of banking institutions, this was not specifically provided to be in lieu of all other state taxes. These associations should be specifically exempted from the tax for the reasons, stated in the discussion of the personal property tax.

The rate of the tax is three percent and it is imposed upon the "annual net earnings or income." In the case of savings institutions without capital stock, the only corporations, from which the tax has been collected, this language has been construed to mean the income after payment of "interest" to members upon their "deposits." It has, therefore, actually been imposed upon annual additions to surplus, established out of earnings. Although its yield has varied, depending upon the interest rates, annually adopted by the managers of the savings institutions, as well as their gross earnings, it has produced rather substantial revenues in the past, considering the small number of companies taxed.[13]

These savings institutions are operated solely for the benefit of, and the encouragement of thrift among, their depositors, and have, therefore, enjoyed a preferential tax status in the past. The tax has imposed some burden upon them, but it is, of course, much lighter than that, to which other corporations are subjected. Furthermore, these institutions have been specifically exempted from paying a personal property or corporate net income tax upon their holdings.[14] Although they operate generally in the banking field, they are not wholly competitive with other banking institutions and, hence, there is no objection to their preferential tax status on this score.

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[13] There are only seven savings institutions without capital stock, doing business in the state.

[14] See this Part (II), under "Personal Property, Corporate Loans and Municipal Loans Taxes."

The co-operative agricultural associations, mentioned above, would seem to deserve a similar preference, and for analogous reasons.

Credit unions are exempted by the act, under which they are created,[15] from all state taxation and, yet in the same act, they are declared to be "institutions of savings." They likewise are operated solely for the benefit of their members. Logically, they should be subjected to the net earnings tax.

The retention of a "catch-all" corporate tax in the state's tax system is desirable, although concededly the state has not fully availed itself of the possibilities of the net earnings tax in the past.[16] Some such tax should be provided to distribute a share of the costs of government upon new and unusual corporate forms of enterprise, which have appeared with increasing frequency in recent years. The net earnings tax should, therefore, be retained in its present form. It should not be altered to impose tax on enumerated corporate entities, but it should be applied by the taxing authorities to all the corporations, herein discussed, which are not subject to some other form of state taxation, such as co-operative corporations, except rural electric co-operative corporations, and credit unions. Corporations, not to be made subject to the tax, such as building and loan associations and mutual insurance companies, should be specifically exempted from the tax.

The statutory description of the tax base could be more explicit. What actually is intended to be taxed is the annual addition or accretion made to capital, surplus, or working funds out of receipts. It should be made clear that this means accretions, coming directly or indirectly out of receipts; otherwise, the door will be open to easy evasion.

Recommendations:

1. That the tax in its present general form be retained as a state tax.

2. That it be extended to credit unions by appropriate amendment to the act under which they were created.

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[15] Section 23, Act of May 26, 1933, P. L. 1076.

[16] For example, in the case of co-operative associations and mutual insurance companies.

3. That it be expressly applied to all co-operative corporations, except rural electric co-operative corporations.

4. That both state and federal building and loan and savings and loan associations and domestic mutual insurance companies be specifically exempted from the tax.

5. That the tax base be more specifically defined, as set forth above.

BIENNIAL TAX COLLECTIONS

NET EARNINGS TAX

Biennium	*Amount (in thousands)*	*Percent of Total Taxes*	*Biennium*	*Amount (in thousands)*	*Percent of Total Taxes*
1923-1925	$206	0.15	1933-1935	$164	0.08
1925-1927	188	0.12	1935-1937	339	0.09
1927-1929	282	0.15	1937-1939	245	0.06
1929-1931	131	0.05	1939-1941	206	0.05
1931-1933	224	0.10	1941-1943	70	0.01
			1943-1945 [1]	306	0.07

[1] Actual and estimated.

CHAPTER 4

INSURANCE GROSS PREMIUMS TAX

Insurance companies were first classified apart from other corporations for tax purposes in 1873,[1] when a tax of 3 percent was imposed upon the gross receipts of all foreign companies, derived from Pennsylvania business; and such companies were exempted from the capital stock tax. The efficiency of this tax in distribution of the burdens of taxation upon foreign insurance companies is evidenced by the fact that it has been retained, substantially unchanged in principle, since it was first imposed as the exclusive method of taxing these companies.

The tax is a peculiarly appropriate method of taxing the insurance business. It bears a direct relationship to the volume of that business; and, since from the very nature of the business, reserves must be set up, commensurate with volume of that business, the burden of the tax likewise varies with the amount of assets, engaged in carrying on the business. For many years the insurance business has been expanding and an ever increasing number of people have been contributing to the aggregate amount of premiums. Since the tax is included in the premium "loading," this circumstance gives it some of the aspects of a broad base tax.

The tax, from a practical standpoint, however, is a tax on insurance business, which is entirely corporate in form, rather than upon persons paying insurance premiums. It is not a "consumption" tax, as such taxes are commonly understood. It is rather a means of distributing the burden of taxation upon this very large and increasingly important business.

Despite its obvious advantages, the tax has never been extended to all domestic insurance companies nor has it been applied as the exclusive method of taxing those domestic companies, upon whose business it has been imposed.

In 1877[2] a gross premiums tax of 8 mills was imposed upon the "entire amount of premiums received" by domestic insurance companies, except those, doing business on the mutual plan without capital

[1] Act of April 4, 1873, P. L. 26.
[2] Act of March 20, 1877, P. L. 6.

stock or accumulated reserves, and purely mutual beneficial associations. This tax was re-enacted as a part of the 1879 [3] tax codification.

Although the inclusion of premiums from business, done outside the state, was obviously inequitable, it was sustained [4] until corrected by the legislature in 1881.[5]

In the 1889[6] tax codification, the gross premiums tax of 8 mills on the receipts of certain domestic insurance companies was continued, but the rate of the tax, respecting foreign companies, was reduced to 2 percent.

A significant provision was attached to the taxing statute in 1895,[7] insofar as the tax, derived from the premiums of foreign fire insurance companies, was concerned. This provision, as last amended in 1935,[8] was to the effect that the net yield of the tax, derived from this source, should be paid over annually to the several cities, boroughs, and townships of the state in proportion to the amount of business, done in each, and the moneys, so paid, were directed to be paid into relief funds of the fire departments or associations, serving these various municipalities.

A somewhat similar provision was enacted in 1943,[9] when one-half of the tax yields, derived from the premiums of foreign casualty companies, was directed to be paid to the several municipalities of the state to be devoted to the Police Pension Funds of such municipalities or to their municipal employes' retirement funds for the benefit of the police members. The act further provides that, if any municipality shall have no such funds, its share of the distributed tax shall be paid into the State Employes' Retirement Fund to the credit of the members of the state police.

Between 1911 and 1939[10] numerous acts were passed, defining deductions, allowable from gross premiums of both foreign and domestic companies, in determining the tax base. Under the last of this

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[3] Act of June 7, 1879, P. L. 112, Sect. 8.

[4] Insurance Co. of No. America v. Commonwealth, 87 Pa. 173.

[5] Act of June 10, 1881, P. L. 99.

[6] Act of June 1, 1889, P. L. 420, Sect. 24.

[7] Act of June 28, 1895, P. L. 408.

[8] Act of April 30, 1935, P. L. 122.

[9] Act of May 12, 1943, P. L. 259.

[10] Acts of June 1, 1911, P. L. 607; May 17, 1921, P. L. 682, Sect. 321; May 6, 1925, P. L. 526; May 31, 1933, P. L. 1093; May 31, 1933, P. L. 1094; May 25, 1939, P. L. 212; May 25, 1939, P. L. 213.

series, the 1939 acts, deductions are permitted in the case of both foreign and domestic companies for "all amounts returned on policies cancelled or not taken and all premiums received for reinsurance." Thus, the state looks to the company, placing reinsurance, instead of the reinsurer, for the tax. Furthermore, such domestic companies, as are required to report and pay the tax, may, in addition, deduct "that portion of the advanced premiums, * * * returned in cash or credit to members of policyholders * * * upon the expiration of their contracts." No comparable provision is made concerning dividends or bonuses, paid policyholders in stock companies, although there was such a provision in the 1911 enactment, supra, respecting premiums of foreign life insurance companies. This anomalous situation would seem to require correction.

In 1917[11] the tax was extended to apply to the premiums, derived from Pennsylvania business by foreign companies, not authorized to do business in the state. It was made the duty of the person or corporation, entering into a contract of insurance *or reinsurance* with such a company, to deduct the tax from premiums and pay it over to the state. So far as reinsurance is concerned, however, this provision only reaches domestic companies, because foreign companies, registered in the state, which make their reinsurance contracts outside the state, are not subject to the provision.[12] With respect to reinsurance of this nature, therefore, domestic companies would seem to be at a competitive disadvantage, because the tax is generally absorbed by the company, which pays it over to the state. In this respect also the provision would seem to be at variance with the principle of the 1939 acts, mentioned above. For these reasons it should be appropriately amended to exempt all reinsurance premiums.

In 1921[13] a retaliatory provision, affecting foreign companies, doing business in the state, was enacted. This provision encompassed not only the taxation, but all other rights and obligations, of insurance companies. However, insofar as taxation is concerned, it provides in effect that, whenever any state imposes a tax upon companies of this state, doing business within its borders, in excess of that, imposed by this

[11] Act of July 6, 1917, P. L. 723.
[12] Connecticut General Life Insurance Co. v. Johnson, 303 U. S. 77.
[13] Act of May 17, 1921, P. L. 789, Sect. 212.

state upon similar foreign companies, doing business here, then the companies of the offending state shall be subject here to a like tax, imposed by such state on Pennsylvania companies.

The practice of taxing foreign insurance companies exclusively on premiums from business, done in the taxing jurisdiction, is almost universal in the United States and Canada and, although there is some variation, the usual rate is 2 percent. Accordingly, the gross premiums tax, imposed with respect to foreign companies in this state, is now at the rate of 2 percent, except in those relatively few instances, where the retaliatory provision comes into play.

The retaliatory provision has an interesting effect with respect to moneys, paid in consideration of annuity contracts. Such payments have been held not to be premiums in Pennsylvania and, hence, are not taxable under the gross premiums taxing statute.[14] In a few states, however, such payments are taxed as premiums, with the result that companies of those states, making annuity contracts in Pennsylvania, are compelled to pay a tax upon the consideration, received therefor, equal in amount to that, which would have been paid, if the consideration in question were in fact a premium under Pennsylvania law.

Also in 1921[15] the business of excess insurance brokers was subjected to a 3 percent gross premiums tax.

In 1925[16] all domestic mutual companies of every kind were exempted from the gross premiums tax. Theretofore, the tax did not apply to those companies, not having capital stock *"or accumulated reserve."* The later qualification was eliminated by the 1925 amendment.

In 1927[17] the "underwriting profits" from marine insurance, attributable to Pennsylvania by the operation of a statutory formula, were subjected to a 5 percent tax in lieu of the gross premiums tax.

Finally, in 1931[18] domestic stock life insurance companies were added to those companies, from which gross premium reports and the resulting tax were not required. It has been suggested that this action

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[14] Commonwealth v. Metropolitan Life Ins. Co., 254 Pa. 510.
[15] Act of May 17, 1921, P. L. 789, Sect. 625.
[16] Act of May 6, 1925, P. L. 526.
[17] Act of May 13, 1927, P. L. 998.
[18] Act of June 26, 1931, P. L. 1408.

resulted from the exemption of mutual companies with accumulated reserves, which was effected by the 1925 amendment.

The gross premiums tax, which once was imposed upon all *foreign* companies, stock and mutual, at the rate of 2 percent, and on all *domestic* stock and mutual companies with accumulated reserves, at the rate of 8 mills, is today imposed only upon all foreign companies, except marine underwriters, at the rate of 2 percent (except in those cases, where the operation of the retaliatory provision results in a higher rate) and upon domestic stock fire, marine, (except marine underwriters) and casualty companies. All domestic life companies, both *stock* and *mutual,* are no longer subject to the tax, nor does it apply to any *mutual* company or association, writing insurance other than life.

The gross premiums tax constitutes an exclusive method of taxing foreign insurance companies with respect to their Pennsylvania business. Domestic stock companies, however, are subject to the capital stock and the corporate net income taxes. Domestic mutual companies are subject to no tax whatsoever. This results in the anomalous situation of subjecting domestic stock fire, marine, and casualty companies to three state taxes, domestic stock life to two state taxes, and all other domestic companies, the mutuals, to no state tax whatsoever.

It is, of course, apparent that domestic mutuals enjoy a competitive advantage taxwise over, not only similar foreign stock, but also similar foreign mutual companies. They likewise enjoy an advantage over domestic stock companies, writing similar busness. It follows that, if the burdens of taxation have been equitably distributed among foreign mutual and stock and domestic stock companies, domestic mutual companies have escaped their fair share to the extent that competitive relationships furnish a criterion.

It is not possible, however, to make the same comparisons, and to draw similar conclusions, between foreign companies and domestic stock companies of the same types, without analyzing the impact of the capital stock and corporate net income taxes upon the latter.

During 1941 and 1942[19] the principal classes of domestic stock insurance companies reported net premiums from Pennsylvania busi-

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[19] Reports for 1942 and 1943, Commissioner of Insurance.

ness of $44,179,000 and $47,268,000, respectively.[20] Although these figures include some premiums, received for reinsurance, a fairly accurate basis for comparison of the relative tax burden upon domestic stock and foreign insurance companies may be obtained by applying the 2 percent rate, to which foreign companies are subject, to these reported premiums.

Class	Number	Premiums (in thousands)	2 Percent of Premiums (in thousands)
1941			
Fire and Marine	27	$14,620	$292
Casualty	13	19,805	396
Life [1]	5	7,615	152
Limited Life [2]	7	2,139	43
1942			
Fire and Marine	27	15,781	316
Casualty	15	21,259	425
Life	15	7,842	157
Limited Life	7	2,386	48

[1] Includes health and accident premiums.
[2] There are ten limited life companies in Pennsylvania, seven of which have capital stock.

The approximate tax[21] burden, actually imposed upon these companies during 1941 and 1942, was as follows:

(in thousands)

Class	Capital Stock Tax	Corporate Net Income Tax	Premiums Tax	Total
1941				
Fire and Marine	$397	$19	$117	$523
Casualty	35	4	158	197
Life [1]	37	none	none	37
Limited Life [2]	4	none	none	4
1942				
Fire and Marine	390	23	126	539
Casualty	32	26	170	229
Life	24	.3	none	24.3
Limited Life	3	none	none	3

[1] Not subject to gross premiums tax.
[2] Not subject to corporate net income or gross premiums tax.

The foregoing tables indicate that the tax burden, imposed by Pennsylvania upon its own fire and marine stock companies, places them at a decided competitive disadvantage with all companies of other

[20] Excluding consideration paid for annuities. Held not to be a premium and not subject to a premium tax. Commonwealth v. Metropolitan Life Ins. Co., 254 Pa. 510.
[21] In the case of fire and marine and casualty companies the net premiums given above are used in computing the 8 mills premiums tax.

states in similar lines, doing business in Pennsylvania. They also indicate that other domestic stock companies are not subject to anything like the tax burden, imposed upon their foreign competitors.

These competitive situations between foreign and domestic companies could be made less extreme by extending the gross premiums tax to domestic mutual companies and, at the same time, reducing the capital stock tax upon fire and marine domestic stock companies and exempting all domestic stock companies from the corporate net income tax.

So far as the domestic mutuals are concerned, it seems fair that they should bear some tax burden. This is emphasized by the fact that foreign mutual companies, doing business in the state, are as heavily taxed as foreign stock companies. Furthermore, thirty states impose some form of tax upon domestic mutual companies, although in certain states some classes of mutuals are exempt. The imposition of an 8 mills gross premiums tax upon the domestic mutuals would still give them preference taxwise over foreign stock and mutual companies, as well as domestic stock companies, but it would mitigate to some extent their present competitive advantage.

While the extension of the gross premiums tax to domestic stock life and limited life companies would still give them some competitive advantage over similar foreign stock and mutual companies, these companies probably should not be subjected to this additional burden. The fact that they paid no income tax in 1941 and practically none in 1942 indicates that they are in an unfavorable economic position under the present tax load.

The foregoing suggestions would likewise result in the imposition of no more than two taxes upon any insurance company. To the extent that they would no longer be subjected to the corporate net income tax, both domestic stock fire and marine and casualty companies would be benefited. This would measurably increase the competitive advantage, which domestic casualty companies have over similar foreign companies, but in this case such resulting advantage would be more proportionate to that proposed in the case of other types of domestic companies.

Domestic stock fire and marine companies, however, are entitled to more substantial relief. Prior to 1935 these companies were subject to a 3 mill instead of a 5 mill capital stock tax. A restoration of this special rate would still leave them at a competitive disadvantage with respect to their foreign counterparts. It would, therefore, seem that the capital stock tax on these companies should be reduced to two mills. A simple calculation, based upon the above figures, will show that this does little more than equalize the competitive situation with foreign companies.

Finally, the foregoing suggestions would simplify and rationalize the taxation of this tremendous business.[22] The gross premiums tax would be recognized for what it is—the most efficient method of taxing the insurance business—by extending it to all companies with the exception of domestic stock life companies, proposed to be exempted because of the special circumstances, set forth above. The two percent rate would be retained for all foreign companies and an eight mill rate would be imposed on domestic companies, except stock life companies. Domestic stock companies would pay only a capital stock tax in addition to the premiums tax and, thus, no company would be subject to more than two taxes. Special cognizance would be taken of the unfavorable situation of domestic stock life and fire and marine companies. By these means the most extreme competitive inequalities would be eliminated.

Because the premiums tax in a sense is a broad base tax, it would seem to be a logical selection for the alleviation of local taxes. As pointed out above, the gross premiums taxes, collected from foreign fire companies and one-half of those, collected from foreign casualty companies, are now devoted to local purposes. This circumstance, to some extent, has placed the domestic companies at a disadvantage. The precedent, however, exists for the dedication of the revenues of the gross premiums tax to local purposes and it is suggested that it be so dedicated specifically for the support of the public school system (excepting, of course, foreign fire and foreign casualty premiums tax, already dedicated). On the basis of recent revenue collections, it is estimated that this would reduce the revenue, available for general state purposes, about $14,000,000 per biennium. But in view of the pro-

[22] Net premiums, derived from Pennsylvania business, were $578,550,000 in 1941 and $594,994,000 in 1942, of which approximately 83 percent was collected by foreign companies.

posal to extend the gross premiums tax to all insurance companies, it would afford local real estate tax relief in a somewhat larger amount.

Because mutual companies, exclusive of life insurance companies, reinsure risks to a very large extent, it is difficult to estimate the yield of an eight mills premiums tax on these domestic companies. Making liberal allowance for reinsurance, it would seem that the proposed extension of the eight mill tax would increase the gross premiums tax at least $700,000 per biennium, which under the plan, proposed above, would also be available for the relief of local real estate taxation.

The proposed extension of the gross receipts tax to mutual companies would nullify[23] two ordinances in the City of Philadelphia, both approved August 17, 1937. These ordinances imposed a two percent tax upon the premiums (of mutual life insurance companies and mutual fire insurance companies, respectively), derived from business, written in Philadelphia. Although the yield of these tax ordinances to the City of Philadelphia has varied, it has averaged between $130,000 and $140,000 annually in recent years.

The loss of this revenue by the City of Philadelphia, however, would be more than compensated, so far as the aggregate tax burden upon her citizens is concerned, by the proposed dedication of the entire gross premiums tax, as extended in the manner herein recommended, to the support of the schools and, thus, to the relief of local real estate taxes. It should, of course, be noted that the School District of Philadelphia is co-extensive with the City and County of Philadelphia.

Recommendations:

1. That the gross premiums tax be changed from a state tax to a state collected tax, dedicated to the public school system.

2. That the eight mill gross premiums tax, now imposed with respect to the premiums of domestic stock fire, marine, and casualty companies be extended to the premiums of all domestic mutual companies.

3. That all insurance companies be exempted from the corporate net income tax, which is presently imposed upon domestic stock fire,

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[23] Act of August 5, 1932, P. L. 45 (Sterling Act).

marine, casualty, and life companies. (See under, "Corporate Net Income Tax.")

4. That domestic stock fire and marine companies be separately classified for capital stock tax purposes and taxed at the rate of two instead of five mills. (See under, "Capital Stock Franchise Tax.")

5. That the present dedication of the tax, derived from premiums of foreign fire insurance companies to local firemen's relief associations, be undisturbed.

6. That the present dedication of one-half of the tax, derived from the premiums of foreign casualty companies, to local police pension and retirement funds be undisturbed.

7. That the Act of June 6, 1917, P. L. 723, requiring residents of Pennsylvania to collect a two percent tax upon premiums, paid by them to foreign insurance companies, not authorized to do business in Pennsylvania, be restricted to premiums, paid upon contracts of insurance, exclusive of reinsurance.

8. That all companies, domestic as well as foreign, doing business on the mutual plan or with participating features, be allowed a deduction in computing taxable gross premiums of "that portion of the advanced premiums, returned in cash or credit to members or policyholders."

9. That, because of almost universal acceptance, the two percent tax upon the premiums of all foreign insurance companies, both stock and mutual, with the present reciprocal features, be retained.

BIENNIAL TAX COLLECTIONS

TAX ON GROSS PREMIUMS OF INSURANCE COMPANIES

Biennium	*Amount* (in thousands) *Domestic*	*Foreign*	*Total*	*Percent of Total Taxes*	*Average State Income* (in millions)
1923-1925	$649	$7,915	$8,564	6.19	$6,149
1925-1927	514	9,711	10,225	6.39	6,356
1927-1929	608	11,033	11,641	6.22	6,587
1929-1931	464	12,237	12,701	5.23	6,775
1931-1933	474	11,979	12,453	5.68	4,793
1933-1935	343	11,338	11,681	5.97	4,216
1935-1937	317	12,055	12,372	3.31	5,046
1937-1939	493	13,252	13,745	3.32	5,416
1939-1941	475	12,469	12,944	3.11	6,052
1941-1943	570	15,473	16,043	3.43	8,075
1943-1945 [1]	368	17,930	18,298	3.96	10,076

[1] Actual and estimated.

Generally, revenues from the gross premiums tax appear to be directly affected by changes in economic conditions, showing marked increases in times of prosperity, but maintaining an exceptionally stable level in unfavorable economic periods. A comparison of collections from the tax on gross premiums of foreign insurance companies and state income provides a better measure of these characteristics than a comparison of total gross premiums tax collections and state income because of the many exemptions, granted to domestic insurance companies over the twenty-year period. The Commonwealth's general experience with the gross premiums tax definitely indicates that increased revenues can be expected in times of expanding state income.

CHAPTER 5

TAX ON SHARES OF BANKING INSTITUTIONS

This tax, which is a tax on capital, was first imposed upon national banks in 1867,[1] shortly after the passage of the National Bank Act,[2] which permitted state taxation of national banks within certain limits. Under the federal act national banks could be taxed on their shares at a rate, not higher than that, imposed on other moneyed capital in the hands of individual citizens of a state. In Pennsylvania this rate, by the Act of 1844,[3] was three mills. Accordingly, the rate of the 1867 shares tax was set at three mills upon the actual value of the shares. The taxing statute originally was, and still is, elective in form—that is to say, if the tax is paid over to the state by the appropriate officer of the bank, the shares, so assessed, are exempted from local taxation in the hands of the holder.[4]

In 1868[5] the tax was extended to all state banks and savings institutions with capital stock. In 1870[6] an optional tax of one percent upon the par value of the shares was imposed, but this option was repealed in 1925.[7]

Meanwhile, in 1885[8] shares of title insurance and trust companies were subjected to the tax, but by the 1889[9] codification of the revenue laws they were placed with other corporations under the capital stock tax.

In 1891[10] the tax on moneyed capital generally was raised to four mills and has been continued thereafter at that rate in the personal property and corporate loans tax of 1913,[11] except for the year, 1935, when it was raised to five mills, and, except for the years, 1936-1942 (inclusive), when it was eight mills. By the same Act of 1891 the bank shares tax was raised to four mills. This provision was succeeded

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[1] Act of April 12, 1867, P. L. 74.
[2] June 3, 1864, c. 106, 13 Stat. 99.
[3] Act of April 29, 1844, P. L. 486.
[4] See Boyer v. Boyer, 113 U. S. 689.
[5] Act of April 2, 1868, P. L. 55.
[6] Act of March 31, 1870, P. L. 42.
[7] Act of May 2, 1925, P. L. 497.
[8] Act of June 30, 1885, P. L. 193.
[9] June 1, 1889, P. L. 420.
[10] June 8, 1891, P. L. 229.
[11] June 17, 1913, P. L. 507.

by the Act of 1897,[12] under which, as variously amended, the tax on shares of national and state banks and savings institutions with capital stock has since been imposed. The tax at the rate of four mills, imposed by the 1897 Act, has remained unchanged, except for the years, 1936 to 1942, inclusive,[13] when, following the emergency rates, imposed upon personal property during that period, the rate was temporarily raised to eight mills.

By the Act of 1891, supra, the rate of tax, imposed upon the capital stock of all corporations, except banks, savings institutions, and foreign insurance companies, but including title insurance and trust companies, was raised to five mills. The latter companies continued subject to the capital stock tax until 1907, when, by a separate act,[14] they were subjected to a tax on shares. This act was similar in language and effect to the bank share tax act of 1897, with two important exceptions:—(a) like the capital stock act, it imposed a tax at the rate of five instead of four mills, and (b) like the bank share act, it fixed the value of the shares at the total of the capital, surplus, and undivided profits of the institution, but in arriving at the taxable value permitted therefrom a deduction of so much of these capital funds as was invested in shares of stock of corporations, liable to pay, or relieved from, a capital stock tax or a tax on shares.[15]

The second difference, above mentioned, between the two shares tax acts was eliminated in 1936.[16] Except for the period, 1936 to 1942,[17] inclusive, when the rate, like the bank share tax rate, was raised to eight mills, the rate upon the shares of title insurance and trust companies and bank and trust companies[18] has remained at five mills.

From the foregoing history it will be observed that the rate of tax upon shares of national and state banks and savings institutions with capital stock has always corresponded with that imposed upon

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[12] July 15, 1897, P. L. 292.

[13] Acts of July 28, 1936, P. L. 76; April 8, 1937, P. L. 254; May 4, 1939, P. L. 53; and July 11, 1941, P. L. 380.

[14] June 13, 1907, P. L. 640.

[15] The provisions of this exemption were altered, but not changed in principle by the Act of May 31, 1933, P. L. 1132.

[16] Act of July 28, 1936, P. L. 73.

[17] Acts of July 28, 1936, P. L. 73; April 8, 1937, P. L. 251; May 4, 1939, P. L. 48; and May 29, 1941, P. L. 75.

[18] Because corporations of this designation were recognized by the Banking Code of 1933, they were included in the tax act by the Act of May 31, 1933, P. L. 1132.

personal property. This is required by the provisions of Section 5219, U. S. Revised Statutes, which limits the power of a state to tax the shares of a national bank to a rate no higher than that imposed upon other moneyed capital in the hands of the state's individual citizens.

On the other hand, the rate of tax, imposed since 1907 upon the shares of title insurance and trust companies and banks and trust companies, has corresponded with the rate of the capital stock tax, except for the period, 1936-1942, inclusive, when temporary additional rates were in force. Since these companies were once subject to the capital stock tax, this procedure, perhaps, was originally logical.

In computing the value of the capital stock for capital stock tax purposes, that portion, invested in shares of another corporation, liable to or relieved from the tax, is deducted,[19] as is also that portion invested in federal securities.[20]

The capital stock tax, unlike the shares tax, is a tax on property.[21] Comparable deductions under the shares tax were only obtained by express statutory provision in the Act of 1907 as to the shares held, and by judicial construction that the deduction with respect to the shares discriminated against federal securities,[22] as to the latter. As has been noted, the language, upon which both deductions depended, was eliminated from this act in 1936.

The bank shares tax act of 1897, however, never contained any language permitting these deductions.

While, obviously, the higher rate of the 1907 act was not offset with mathematical exactness by the deductions, permitted under it, the additional mill in the rate was, perhaps, justified by the different method of computing the tax base; and the separate classification of banking institutions, taxed under the Act of 1907, from those, taxed under the Act of 1897, was legally sustainable.[23]

An additional reason, once supporting this difference in rate, was the difference between the powers, enjoyed by banks and trust companies, the principal of which was the "trust powers," possessed by the latter. By successive amendments to the National Bank Act all the

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19 Com. v. Westinghouse Air Brake Co., 18 Dau. 174.
20 Com. v. Lehigh Coal & Navigation Co., 162 Pa. 603.
21 Com. v. Beech Creek R. Co., 188 Pa. 203.
22 Schuylkill Trust Co. v. Com. 296 U. S. 113, 302 U. S. 506.
23 Com. v. Mortgage Trust Co., 227 Pa. 163.

powers, which theretofore gave trust companies competitive advantages over national banks, were made available to the national banks. Other differences were eliminated by the Pennsylvania Banking Code of 1933.

The difference in rate, therefore, originally was justified by substantial differences, competitive and tax-wise, between the two classes of institutions. To the extent that these differences survive, they are wholly inconsequential. This proposition has already received legislative recognition, when in 1936 temporary emergency rates raised the tax on both classes to eight mills. With the recent elimination of such rates, however, the original rate differential has been re-established.

Equity requires that the shares of all banking institutions be now taxed at the same rate and on the same base. Because of Section 5219, this can only be accomplished by reducing the rate upon the institutions, taxed under the 1907 act, to four mills. This will not greatly affect the revenues of the Commonwealth. On the basis of 1941-1943 receipts, it would reduce the state's biennial revenue by only about $660,000.

A minor defect in both acts is the requirement that banking institutions collect the tax from their shareholders and pay it over to the state. Prior to 1933, they had the option of paying the tax out of their general funds. The sole reason for the elimination of this option was the groundless fear[24] that it converted the tax into a property tax, the consequences of which would have been the flat deduction of federal securities from the tax base.

The almost universal practice of the banks, however, both before and after 1933, has been to pay the tax out of their general funds, because the proportionate liability of the shareholders for the tax was the same as their interest in the general funds of the institution.

Institutions, thus paying the tax, can deduct it for federal income tax purposes because the Internal Revenue Code provides[25] that taxes, paid by a bank, but assessed against its shareholders, are deductible, where the bank is not reimbursed by such shareholders.

It has recently been held that shares of banking institutions, held by charities, are not subject to the tax.[26] It is, therefore, questionable

[24] So held to be in Schuylkill Trust Co. v. Com., 296 U. S. 113, 302 U. S. 506.
[25] Section 23, Regulation III., Sec. 29-23 (d)-1 and as ruled to be specifically applicable to Pennsylvania banks in GCM 21329, 1939-2, C. B. 179.
[26] Com. v. First National Bank of Scranton, 53 Dau. 245.

whether certain institutions will wish to continue to pay the tax out of their general funds. But others, so desiring, should be permitted to do so without jeopardizing the federal tax deduction, a possibility, which might materialize, if the technically irregular practice in question ceases universally to be followed. A restoration of the optional method of payment would afford more adequate support for the continuance of the present favorable federal ruling.

It would seem that the law should provide that all shares of banking institutions, regardless of the identities of the holders, should be subject to tax. The shares tax in essence represents the contribution of the banking business, as such, to the cost of government. This is practically recognized by the payment of the tax out of general funds and it has been judicially exemplified by the holding that shares, held by nonresidents, are subject to the tax.[27] This suggestion would also eliminate many complex and unnecessary problems, raised by the court decision that shares, held by charities, are exempt, while shares, held by nonresidents, are taxable. This suggestion will not affect the state's revenues.

The tax on shares should be retained as the method for taxing banking institutions in Pennsylvania. Section 5219 of the Revised Statutes provides four mutually exclusive methods for state taxation of national banks. They are (a) a tax on shares, (b) a tax on dividends, paid to the holder of the shares, (c) a tax on net income and (d) a tax according to net income. The limitations upon the tax on shares have already been discussed. A tax on dividends is limited by the rate of the state's individual income tax. This method is not practical under the construction of the tax clause of the State Constitution by the State Supreme Court.[28] Taxes on or according to the net income of national banks are limited to a rate, no higher than that imposed upon the income of other corporations, doing business in the state. The latter is, therefore, legally available in Pennsylvania, because the corporate net income tax[29] is imposed on other corporations.

Under such a tax, however, banking institutions would not bear a commensurate part of the total tax burden and the revenues from this

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[27] Schuylkill Trust Co. v. Com., 296 U. S. 113, 302 U. S. 506.
[28] Kelley v. Kalodner, 320 Pa. 180, Butcher v. Philadelphia, 333 Pa. 397.
[29] Act of May 16, 1935, P. L. 208, as reenacted by the Act of May 7, 1943, P. L. 217.

source would be characterized by the instability, which is inherent in a tax, measured by net income.

It must be remembered that national banks can be taxed by only one of the four methods specified in section 5219. They, unlike other corporations, cannot, in addition, be subjected to the capital stock tax. It has been shown that fairness and equity require a policy of taxing all banking institutions, whether national or state, in the same manner, at the same rate, and upon the same base, especially since by far the majority of such institutions are national banks.[30]

If all of these institutions were taxed according to their net income at the four percent rate of the corporate net income tax, the revenue from this source would only be about 30 percent of that derived from the tax on shares. This is demonstrated by the following computation, which is based upon latest available figures, released by the Bureau of Internal Revenue. In this computation "compiled net profit" as well as "taxable net income" is included, because during the years in question banking institutions held substantial amounts of income producing, but tax exempt, federal securities. Such holdings are likely to decrease sharply in the future.

	1940 (1109 Pa. Banks)	*1941* (1085 Pa. Banks)
Compiled Net Profit	$39,415,734	$35,361,346
Tax thereon at four percent	1,576,629	1,414,453
Taxable Net Income	27,876,297	26,740,115
Tax thereon at four percent	1,115,051	1,069,604
Actual Yield of Tax at Normal rates	4,003,542	3,534,309
Ratio Income Tax to Tax on Shares	27.85%	30.26%

Recommendations:

1. That the tax on shares be retained as a state tax.

2. That the rate of the tax on title insurance and trust companies and bank and trust companies be reduced from five to four mills.

3. That banking institutions be given the option of paying the tax out of their general funds or collecting it from their shareholders and remitting it to the state.

4. That all shares of banking institutions be subjected to the tax.

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[30] On January 1, 1943 there were 676 national banks, 167 state banks, and 208 trust companies and bank and trust companies in Pennsylvania.

BIENNIAL TAX COLLECTIONS

TAX ON SHARES OF BANKING INSTITUTIONS

Biennium	*Amount* (in thousands) *Normal Tax*	*Emergency Tax*	*Total*	*Percent of Total Taxes*	*Average State Income* (in millions)
1923-1925	$3,017	....	$3,017	2.18	$6,149
1925-1927	4,331	....	4,331	2.70	6,356
1927-1929	7,030	....	7,030	3.76	6,587
1929-1931	9,201	....	9,201	3.79	6,775
1931-1933	6,259	....	6,250	2.85	4,773
1933-1935	4,813	....	4,813	2.46	4,216
1935-1937	4,267	$261	4,528	1.21	5,046
1937-1939	8,747	5,816	14,563	3.52	5,416
1939-1941	7,044	5,667	12,711	3.05	6,052
1941-1943	7,554	6,774	14,328	3.06	8,075
1943-1945 [1]	7,265	5,965	13,230	2.86	10,076

[1] Actual and estimated.

In the period, 1923-1931, the expansion in the banking business, following World War I, was marked by a decided increase in revenues from the tax on shares of banking institutions, which rose from $3.0 million in 1923-1925 to $9.2 million in 1929-1931. From 1931 on, however, the biennial revenues from this tax were very irregular and subject, apparently, to several extraordinary factors. One of these was probably the bank failures of the early 'thirties, while the peak of revenues in 1939-1941, after two biennia of exceptionally low collections, resulted from the decision of the Supreme Court of the United States in the case of Schuylkill Trust Company v. Commonwealth, 302 U. S. 506 (1938), combined with the inability of banks to pay taxes *without prejudice,* prior to The Fiscal Code amendments of 1935-1937. Pending decision in the case, cited above, payments of trust company taxes were withheld, so that payments, due in prior years, accumulated in the 1937-1939 biennium.

Since bank taxes are levied on the value of shares, which is determined by adding together capital, surplus, and undivided profits, with certain deductions, it is not to be expected that revenues from this tax will be particularly responsive to economic trends, for although additions to surplus tend to decrease somewhat as bank earnings decline, these earnings have not varied in close relation with general economic conditions. With large investments in federal securities at low rates of interest, enormous cash balances, and restricted commercial and mortgage loans, bank earnings from operations have declined, despite a rise in state income, and are likely to continue to do so in the future. Generally, the revenues from the tax on shares of financial institutions, apart from the questions of bank failures, are fairly stable in depression years, but have shown little response to improved business conditions and rising state income.

CHAPTER 6

TAX ON BUILDING AND LOAN AND FEDERAL SAVINGS AND LOAN ASSOCIATIONS

Building and loan and federal savings and loan associations are wholly exempt from taxation in Pennsylvania. While these corporations cannot efficiently be taxed like other corporations because of the nature of their business, it would seem only equitable that they should bear some share of the cost of government. Money, now invested in their shares, would be directly taxed under the personal property-corporate loans tax, if invested in obligations of other corporations, and it would be also taxed indirectly under the capital stock or shares tax, if invested in stock of other corporations. The present situation, therefore, affords to the investor a tax exempt, but privately-owned and privately-operated field of investment, from which the returns are fairly comparable to other investments.

On the other hand, these associations are quasi-mutual in nature and are created to foster thrift and, to some extent, to encourage home owning and building among the people. As such, they may be said to have a traditional preferred tax status. However, this preference should not appertain insofar as their operations, and such funds as may be invested with them, do not directly subserve these desirable social ends.

The difficult question of the extent to which state building and loan associations should be subject to tax was satisfactorily solved by the Act of 1897,[1] which imposed a tax of four mills upon shares of an association, upon which dividends or interest were paid, but specifically exempted unmatured and liquidating shares. Thus, moneys, invested in an association for the purpose of obtaining an income return, were taxed in a manner similar to other personal property; but moneys, paid into the association to liquidate a mortgage and not primarily to obtain income, were exempt. This act, however, was repealed in 1937[2] because of the complete exemption from taxation, then enjoyed by the newly created and competing federal savings and loan associations.

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[1] Act of June 22, 1897, P. L. 178.

[2] Act of March 15, 1937, P. L. 62.

These associations were totally exempted from state taxation by Act of Congress.[3]

However, in 1939[4] the federal statute was amended to permit the states to impose upon the federal associations a tax no greater than that, imposed upon "local mutual or co-operative thrift and home financing institutions." The way is, therefore, open to tax the interest of dividend-paying shares of both types of or types of organizations in the same manner and to the same extent as such shares of building and loan associations were taxed prior to 1937. A provision accomplishing this result might be added to the County Personal Property Tax Act.

Recommendation:

That a provision, imposing a tax, similar to that, formerly imposed by the Act of 1897, and applicable to both state and federal building and loan and savings and loan associations, be added to the Personal Property Tax Act.

BIENNIAL TAX COLLECTIONS

TAX ON BUILDING AND LOAN ASSOCIATIONS

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Biennium*	*Amount* (in thousands)	*Percent of Total Taxes*
1923-1925	$147	0.11	1933-1935	$463	0.24
1925-1927	277	0.17	1935-1937[1] ...	911	0.24
1927-1929	473	0.25	1937-1939	129[2]	0.03
1929-1931	381	0.16	1939-1941	14[2]	0.003
1931-1933	551	0.25	1941-1943	11[2]	0.002
			1943-1945[3] ...	38[2]	0.008

[1] Tax repealed by Act of March 15, 1937, P. L. 62.
[2] Collection of delinquent taxes.
[3] Actual and estimated.

[3] Authorized by the "Home Owners Loan Act of 1933," 48 Stat. 128, 12 U. S. C. A. 1464.
[4] Amendment of August 10, 1936, 53 Stat. 1402.

CHAPTER 7

PRIVATE BANKERS' GROSS RECEIPTS TAX

A gross receipts tax at the rate of three percent was first imposed upon private bankers and brokers in 1861.[1] In 1864[2] and again in 1879[3] these taxpayers were given the option of paying this gross receipts tax or a three percent tax on their net earnings. The net earnings tax, however, as re-enacted in the 1889 codification of the revenue laws,[4] made no reference to private bankers and brokers, and, hence, impliedly repealed the previous statute. In so doing, the gross receipts tax was revived, as the exclusive method of taxing these businesses. Although the 1879 statute is obsolete, it should probably be explicitly repealed.

In 1895[5] real estate brokers were omitted from the enumeration of the persons taxed and in 1901[6] the rate of the tax was reduced to 1 percent. In 1929[7] all brokers were excluded from the act so that the tax is now imposed solely upon private bankers. The last act was a belated recognition of the fact that brokers had been subjected to the mercantile license tax in 1907,[8] now repealed.[9]

The present tax is imposed on gross receipts from "commissions, discounts, abatements, allowances and all other receipts" (formerly "all other profits"). It represents the share of the cost of government, borne by private bankers, in recognition of the fact that they are expressly privileged to engage in a specialized and, at one time, highly lucrative business activity. Practically all private bankers are, because of the nature of their business, either individuals or partnerships. The privilege of doing business, which they enjoy, therefore, could not be taxed under any of the taxes, which distribute similar burdens upon competing corporate enterprises.

It is to be noted, however, that, since the repeal of the mercantile

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1 Act of May 16, 1861, P. L. 708.
2 Act of April 30, 1864, P. L. 218.
3 Act of June 7, 1879, P. L. 112.
4 Act of June 1, 1889, P. L. 420.
5 Act of June 27, 1895, P. L. 396.
6 Act of June 13, 1901, P. L. 559.
7 Act of April 25, 1929, P. L. 679.
8 Act of May 7, 1907, P. L. 175.
9 Act of May 7, 1943, P. L. 237.

license tax system in 1943, this tax is the only remaining state levy, imposed upon any unincorporated business as such.

In addition to the gross receipts tax, private bankers are subjected to the personal property-corporate loans tax upon their securities.[10] Since the "moneyed capital" of private bankers is in competition with national banks, this is required by Section 5219, U. S. Revised Statutes.

The number of private bankers in the state has been rapidly diminishing in recent years; only fifteen remain. Since their privilege of doing business unquestionably should bear a share of the tax burden, and, since the gross receipts tax has satisfactorily accomplished that end in the past, it seems undesirable to disturb it.

Recommendations:

1. That the tax of one percent upon the gross receipts of private bankers be retained.

2. That the obsolete Act of June 7, 1879, P. L. 112, be repealed.

BIENNIAL TAX COLLECTIONS
PRIVATE BANKERS' GROSS RECEIPTS TAX

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Biennium*	*Amount* (in thousands)	*Percent of Total Taxes*
1923-1925	$84	0.06	1933-1935	$68	0.03
1925-1927	102	0.06	1935-1937	51	0.01
1927-1929	38	0.02	1937-1939	195	0.06
1929-1931	25	0.01	1939-1941	33	0.008
1931-1933	56	0.03	1941-1943	48	0.01
			1943-1945[1] ...	13	0.003

[1] Actual and estimated.

[10] Commonwealth v. McKean County, 200 Pa. 383; Commonwealth v. Stephano Bros., 53 Dau. 424.

CHAPTER 8

BONUS

Bonus has been defined as "a price, paid for a charter" of a corporation.[1] It is not a tax,[2] although in some states a similar exaction is known as an "organization" tax.[3]

Prior to the Constitution of 1874, special incorporation acts from about 1849 onward generally provided for the payment of a fee, based upon the actual capital of the corporation, so formed. In 1868 a general act provided for the payment of a "bonus" by all corporations, except "railroad, canal, turnpike, bridge, or cemetery companies and companies incorporated for literary, charitable or religious uses," on the authorized capital of such companies and also upon any subsequent increase thereof.[4] The general incorporation act of 1874[5] contained similar provisions. In 1899[6] all domestic corporations, except building and loan associations and corporations of the first class, were subjected to the bonus, and in 1901[7] bonus, subsequent to the initial payment, was made payable only on actual increases of capital stock.

In 1927[8] the act, currently imposing domestic bonus, was enacted. Its enforcement provisions, however, were extensively amended in 1939.[9]

Meanwhile, in 1901[10] all foreign corporations (except foreign insurance companies), doing business in the state, were subjected to the payment of a bonus, which to a degree was comparable to that imposed on domestic corporations.

Bonus, imposed upon a domestic corporation, is currently at the rate of one-fifth of one percent on the original authorized capital and a like amount upon each subsequent actual increase thereof. In the case of a corporation with nominal or par value shares, the capital, subject to bonus, is the aggregate par value of the shares, originally or

1 Commonwealth v. Alliance Coal and Mining Co., 13 W. N. C. 324.
2 Commonwealth v. Bailey, Banks & Biddle Co., 20 Pa. Super. 210.
3 F. M. Eastman, Private Corporations in Pennsylvania (Second Ed.), Vol. I, Sec. 777.
4 Act of May 1, 1868, P. L. 108.
5 Act of April 29, 1874, P. L. 73.
6 Act of May 3, 1899, P. L. 189.
7 Act of February 9, 1901, P. L. 3.
8 Act of April 20, 1927, P. L. 322.
9 Act of June 21, 1939, P. L. 609.
10 Act of May 8, 1901, P. L. 150.

subsequently issued. In the case of a corporation, having shares without par value, the amount of the capital, subject to bonus, is the corporation's stated or declared value, whether in money or property, with which it begins business or on account of which stock is subsequently issued. Every domestic corporation, subject to bonus, is required to make an annual report to the Secretary of the Commonwealth, whether or not bonus is actually due for the year, for which the report is made.

On the other hand, bonus, imposed upon a foreign corporation, is at the rate of one-third of one percent of the amount of its capital, wholly employed within the state, and a like amount upon each subsequent increase of capital, so employed. In practice, capital, wholly employed by a foreign corporation within the state, is deemed to consist of its tangible property therein. Every foreign corporation is required annually to file a bonus report with the Department of Revenue, but is required to pay bonus only once on any given amount of capital. However, it has been held that foreign corporations, authorized to transact business in Pennsylvania prior to May 8, 1901, the date of the enactment of the Foreign Bonus Statute, are exempt from its provisions.[11]

In the case of a merger of domestic corporations, the resultant corporation is given credit for the bonus, paid by its components. A similar provision is made with respect to the merger of a foreign with a domestic corporation. However, it would seem that no credit for bonus payment is given in the event of the consolidation of two foreign corporations.[12]

Although bonus is not technically a tax upon corporations, doing business in Pennsylvania, it constitutes a pecuniary burden upon them and, as such, to some extent it parallels the regular corporation taxes. If bonus be considered a fee, exacted for the privilege of doing business in the state, it duplicates the corporate net income tax, which is specifically levied upon that privilege. If, on the other hand, it be deemed to be imposed upon the amount of capital, employed in the state, it is based upon one of the factors, used in determining the capital stock-franchise tax. Essentially, the same privilege or the same capital, as the case may be, would seem to contribute annually to the sup-

[11] Commonwealth v. American Steel Hoop Co., 11 Dau. 92, 226 Pa. 6.
[12] Commonwealth v. Merchants Ship Building Corp., 26 Dau. 89.

port of the government through these two forms of taxation. Finally, if bonus be looked upon as an incorporation fee or a registration fee in the case of domestic and foreign corporations, respectively, it duplicates in most instances, the statutory fee of $30.00, charged for the issuance of certificates of incorporation or authority to transact business. In the case of domestic corporations, the bonus on actual increases of capital to some extent also duplicates the $30.00 statutory fee, charged for the amendment to charters, authorizing increased capitalization, which, under the circumstances, is a necessary prerequisite to the actual issuance of the additional shares of stock. The desirability of incorporating the bonus charge in a scientific tax system is therefore subject to serious question.

The existence of the bonus charge has brought about the practice of chartering domestic corporations with a nominal capital, because at the time of incorporation the bonus must be paid on the authorized capital. Subsequently, such charters are amended and the authorized capital is increased. Where charters are so amended, the bonus is not imposed on the increased authorized capital, but on the increased capital employed. By repealing the domestic bonus act, this undesirable procedure to increase the capital of a corporation would be avoided and corporate records, accordingly, be simplified.

The bonus, imposed upon foreign corporations, has many undesirable features. In the first place, if no bonus were exacted from such corporations, while domestic companies were subjected to it, the latter would be discriminated against. But this exact situation exists with respect to foreign corporations, authorized to transact business prior to 1901.

On the other hand, the difference in rate and incidence between domestic and foreign bonus has resulted in certain curious subterfuges. For example, if a foreign company desires to acquire real estate in Pennsylvania, subject to a large encumbrance, it will organize a domestic subsidiary with nominal capital for the sole purpose of holding title to the property. In such event its domestic bonus would be inconsequential, whereas, if it registered in the state and acquired the property directly, its foreign bonus would be computed on the whole value of the property without deduction for the encumbrance.

In addition to the fact that the exemption of certain foreign corporations creates a fundamental inequity among such corporations, the bonus, as now imposed upon those foreign corporations, subject thereto, does not operate equitably. Since, as a practical matter, bonus is computed on gross tangible property in the state, a foreign company, requiring a heavy investment in such property, is more heavily burdened than another foreign company, though transacting an equal or greater volume of business, whose operations do not require such an investment.

The discrimination against foreign corporations in the case of merger has already been mentioned.

The inevitable effect of these inequalities and discriminations is to make Pennsylvania less attractive to corporate industry, thereby discouraging employment.

In the past the enforcement of the bonus acts, especially with respect to increases in capital, was most difficult and generally ineffectual. While this situation has been somewhat corrected by the 1939 amendments, insofar as domestic corporations are concerned, the imposition and collection of bonus from foreign corporations still remain uncertain and unsatisfactory. Innumerable administrative problems have arisen concerning the ascertainment of the base, upon which foreign bonus is to be computed. For example, it is almost impossible to determine the proper allocation of mobile tangible property. While these difficulties are in part due to the vagueness of the statute in defining the precise base, upon which foreign bonus is to be computed, they are also, in a measure, reflections of inherent defects in the theory, upon which the statute is drawn.

It is pertinent to note that no other state uses the Pennsylvania basis in subjecting foreign corporations to fees, comparable to the bonus.

An analysis of organization and registration fees and taxes of the several states discloses that the Pennsylvania bonus, both on domestic and foreign corporations, is the highest in the Union. This certainly tends to deter the location of corporations in this state.

Since 1939, all corporations, liable to the payment of bonus, are subject to the burden of filing reports, but only a comparatively small proportion of such reports disclose any actual bonus liability. For example, in 1941 only 439 out of approximately 20,000 domestic corporations paid bonus. The consequent futility of making up the great majority of such reports has resulted in widespread disregard of the law, with resulting administrative problems on the part of the state. This is especially true in the case of moribund or "out of existence" corporations, which file no corporate tax reports, but apparently are required to file bonus reports, although in no case is there any possibility that such corporations will owe any bonus as a result of such reports.

The revenue, derived from bonus, is most unstable and does not appear to be related to economic conditions in any marked degree. It is doubtful whether the amount involved justifies either an annual report from almost every corporation, doing business in the state, or the administrative personnel, necessary to handle these reports, particularly in view of the fact that an established and satisfactory means of obtaining revenue from such corporate sources is afforded by the regular corporate taxes.

In most of the other states fees for incorporation are graduated on the basis of authorized capital, although in some the fee is limited to a maximum amount. On the other hand, a substantial number of states impose a fixed fee for the registration of foreign corporations.

Recommendation:

That the acts imposing bonus on domestic and foreign corporations be repealed.

BIENNIAL TAX COLLECTIONS

BONUS

	Amounts (in thousands)				*Average*
Biennium	*Domestic*	*Foreign*	*Total*	*Percent of Total Taxes*	*State Income* (in millions)
1923-1925	....	....	$3,464 [1]	2.50	$6,149
1925-1927	....	....	3,361 [1]	2.10	6,356
1927-1929	$1,857	$1,148	3,005	1.61	6,587
1929-1931	1,247	1,002	2,249	.93	6,775
1931-1933	335	607	942	.43	4,773
1933-1935	286	396	682	.35	4,216
1935-1937	645	647	1,292	.35	5,046
1937-1939	446	720	1,166	.28	4,416
1939-1941	225	392	617	.15	6,052
1941-1943	280	1,089	1,369	.29	8,075
1943-1945 [2]	213	726	939	.20	10,076

[1] Combined total.
[2] Estimated and actual.

The corporation bonus is the largest of the minor "tax" revenues of the Commonwealth, although its receipts in 1941-1943 represented only 0.3 percent of the Commonwealth's total tax revenues in that biennium. A review of the above table reveals no relation between biennial revenues and state income and the erratic pattern of tax receipts marks this source of revenue as most unstable and unpredictable.

CHAPTER 9

UTILITY GROSS RECEIPTS TAX

This tax, which, in effect, is a capital tax, was first imposed in 1866 on railroad, canal, and transportation companies.[1] In 1873[2] the tax was abolished, but was revived and extended in 1877[3] to include railroad, canal, steamboat, slack water navigation, transportation, street passenger railway, telegraph, express, palace-car and sleeping car companies, incorporated or unincorporated, and doing business in Pennsylvania. The tax was re-enacted in 1879,[4] when pipe line and conduit companies and limited partnerships, engaged in transportation, were added to its coverage. The Act of 1889[5] re-enacted the tax, added telephone and electric light companies, but limited the taxable gross receipts to those received from business, done wholly within the state. This latter provision was necessitated by the decision of the United States Supreme Court, which held that receipts, derived from interstate commerce might not be taxed by states.[6] The receipts of foreign companies, derived from business carried on wholly within the state, are taxable.[7]

The 23rd section of the Act of 1889 has been amended ten times and the last six of these amendments dealt, in the main, with the increased rates, imposed by the emergency taxes of 1935-1936, and their continuation in subsequent years.

In 1925, following an attempt to hold municipalities liable for the tax on receipts, derived from electric light business, the law was amended to relieve municipalities from the payment of the tax.[8] In the same year receipts from transportation of freight or oil by any entity and of waterpower and hydroelectric companies were made subject to the tax.[9] In 1927 taxicabs were specifically exempted from the

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1 Feb. 23, 1866, P. L. 82.
2 Mar. 21, 1873, P. L. 46, sec. 3.
3 Mar. 20, 1877, P. L. 6.
4 June 7, 1879, P. L. 112.
5 June 1, 1889, P. L. 420, sec. 23.
6 Phila. & Southern Mail S. S. Co. v. Com., 122 U. S. 326.
7 Western Union Telegraph Co. v. Com., 110 Pa. 405.
8 May 13, 1925, P. L. 702.
9 May 14, 1925, P. L. 706.

tax.[10] In 1929 traction companies were added and motor buses and motor omnibuses exempted from the tax.[11]

In the meantime it had been held that, if the gross receipts tax is levied on a corporation and not on an individual, doing the same business, the tax is invalid.[12]

In 1931, by separate act,[13] individuals and companies, engaged in the business of carrying passengers and freight for hire over the highways in motor vehicles and trackless trolleys, were subjected to a tax of 8 mills on gross receipts. In the case of interstate operations the tax is determined upon such portion of the gross receipts as is represented by the ratio that the number of miles of routes, operated in Pennsylvania, bears to the total mileage operated by the company. Deductions against the tax are allowed for excise taxes, paid by such carriers to cities, and for registration fees, paid to the state for the registration of its vehicles.

In 1935 section 23 of the Act of 1889 was further amended[14] to exempt street passenger railway and traction companies from the tax, and, by the same act, municipalities, operating a utility service, were subjected to the tax on so much of their gross receipts as were derived from business, done outside the limits of the municipality, operating the public utility service.

It is interesting to note that, while the gross receipts tax is imposed on private companies, doing a particular class of business, the tax on municipalities is not imposed on a class of utility business, but on gross receipts, derived from any public utility business. Thus, while private water companies are not subject to the tax, it appears that, where a municipality operates a water supply system, it is technically subject to the tax on all receipts from consumers of water, residing outside the limits of the municipality.

The Department of Revenue has not made any attempt to collect taxes from municipalities, operating water plants, but has limited the application of this provision of the act to taxes on gross receipts, derived by municipalities operating electric light plants.

[10] May 13, 1927, P. L. 1002.
[11] April 25, 1929, P. L. 662.
[12] Quaker City Cab Co. v. Com., 277 U. S. 389.
[13] June 22, 1931, P. L. 694.
[14] May 16, 1935, P. L. 200.

Although not enumerated, air transportation companies are subject to the tax under the classification of "transportation companies."

Amendments to the gross receipts taxes, subsequent to 1935, changed the law only in respect to the rate, except the amendment of 1943, which provided that sales of energy for resale by electric light and power companies to companies, subject to the tax, were to be exempted therefrom.[15] The obvious purpose of this provision was to prevent double taxation upon sales of electric energy.

From this review it will be seen that the gross receipts tax applies to the whole privately operated utility field, except gas, water, and steam heat companies, which have never been subject to the tax, and street passenger railway and traction companies, which are now exempted from the tax. Taxicab companies, once subject to the tax, imposed by the 23rd section of the Act of 1889, and later exempted from that tax, are now included under the Act of 1931.

Municipal authorities, which recently have acquired 32 private water companies, are exempt from all taxation.[16] The companies, so acquired, paid taxes on capital stock and corporate loans to the Commonwealth in 1938 in the amount of $107,437. The yields of corporate net income tax, paid by these companies, could not be ascertained.

Rural electric co-operative corporations, which compete with private electric light and power companies, are also exempted from all taxation, except a membership tax of 10 cents.[17] Thirteen such cooperatives have been organized in this state. They have developed a tax-free utility business, which would ultimately have been developed by regulated and taxed utility companies.

The tax on gross receipts has generally been viewed as a tax in lieu of a local tax on such real estate of utility companies as is essential to the exercise of their corporate franchises. The local taxation of such real estate, as power plants of electric light and power companies, or hydroelectric power dams, or rights-of-way of railroads, presents untold difficulties of valuation, unless the valuation is made by some state body on a uniform basis. Furthermore, many power plants are located in sparsely settled communities, while the greater number of

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[15] May 21, 1943, P. L. 334.
[16] June 28, 1935, P. L. 463, Sec. 15.
[17] June 21, 1937, P. L. 1969, Sec. 31.

consumers, who should have the benefits of any real estate tax on such plants, live in communities, which would receive none of it.

The companies, which pay the gross receipts tax, also pay the capital stock and corporate net income tax. No other business is presently subject to the payment of three state taxes, except domestic stock fire and casualty insurance companies, and in the case of these companies, the corporate net income tax is negligible. It is submitted that it is sound to establish the concept that no taxpayer should be called upon to pay more than two state taxes, with the exception of utilities, where a third tax is perhaps justified because of the real estate tax exemption, noted above. The tax on utility gross receipts affords a simple and inexpensive method of securing revenue in lieu of a tax on the essential corporate real estate. Since real estate is not taxed for state purposes, the revenue, derived from this alternative, should be shifted to local government. It would smooth out the picture of the taxation of utilities for state and local purposes. This tax may be used to relieve the burden of taxes on real estate for the support of the public schools.

Water companies have never been subjected to the gross receipts tax. While the reason for this exemption is not clear, it is probably due to municipal ownership and operation in this field, which developed contemporaneously with private water company development, and to the principle that the cost of necessities of life should be kept as low as possible. There may also have been legislative hesitation in taxing private companies and exempting municipal plants. Recently, the situation in the public water supply field has completely changed. With the development of the *authority* form of operation, the works of many private companies have been sold and the tax revenues of the Commonwealth have accordingly been affected. The extent, to which authorities have spread, is referred to elsewhere.

Water supply utility business, operated by a municipality or an authority, is not a governmental function; it is a proprietary business. The constitutional provision, authorizing the exemption from taxation of public property, does not apply to property, operated in a proprietary capacity or by an authority. Yet the act, creating municipal authorities, exempts them from all taxation. This exemption, of necessity, creates a differential in rates for public service between consumers, who receive service from privately owned companies, subject to capital stock and corporate net income taxes and to federal taxes, and those, receiving service from municipally or authority-owned tax exempt properties. It is quite clear that most municipalities are not engaged in the utility business for the sole benefit of consumers, for in 1943 the municipally owned utilities had aggregate profits of more than $13,000,000.

In order to prevent the destruction of a large part of the utility tax base and to prevent the shifting of taxes from certain communities to others, it seems quite clear that some form of taxation should be applied to this utility business, operated by municipalities and authorities. It is frankly admitted by proponents of municipal authorities that their successful operation is due in large part, if not almost wholly, to tax exemption.[18] The gross receipts tax is the logical tax, which may be imposed, particularly, where the revenues from the tax are to be used for local purposes in relief of the tax on real estate. The extension of this tax to the municipal and authority-operated utilities assures some contribution to public revenues by all rate payers.

Private water companies, as well as municipalities and authorities, have a complete monopoly in their respective territories, and no competition whatever from any other form of enterprise. The private water companies are thus in a position to secure from the Public Utility Commission rates, sufficiently high to assure profitable operation. Taxes imposed are allowed as an operating expense.

Furthermore, it would appear that, if a gross receipts tax is imposed on municipal and authority-operated water supply systems, a like tax must be imposed on private companies in order to assure the constitutionality of the tax.[19]

It is recommended that private water companies, municipalities, and municipal authorities, operating water plants, be subjected to the gross receipts tax.

The Act of 1931,[20] which imposes an 8 mill tax on gross receipts, derived from the transportation of passengers and freight by motor vehicle and trackless trolleys, produces practically no tax. This is due

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[18] Address of David M. Wood, Esq. at first annual conference of Municipal Authorities Nov. 18, 19, 1943.

[19] Quaker City Cab Co. v. Com., 277 U. S. 389.

[20] June 22, 1931, P. L. 694.

to the credits against the tax of excise taxes and fees, paid to cities, and motor vehicle registration fees, paid to the Commonwealth.

More than 8,500 tax reports are filed every six months under the Act of 1931. All of these reports must be audited. A testing of 1,348 company reports shows that in 1942 forty-five companies paid gross receipt taxes of only $4,552, in 1943 fifty-two companies paid only $7,062, and in the first six months of 1944 twenty-nine companies paid only $830. The yields from the tax do not justify the making and auditing of these reports. In its present form the tax cannot be defended.

The receipts and, in some cases, the profits of the business of motor transportation of passengers are presently inflated because of the war emergency. Bus traffic has doubled, but will undoubtedly again become normal after the war ends, when private passenger vehicles can secure unlimited quantities of motor fuel. At the same time, even with greatly increased business, it appears from a study of earnings that at least some urban bus companies are not at present realizing a commensurate return. It is difficult now to measure the extent to which this business can bear taxes in normal times, when traffic and, consequently, gross receipts will decline, but operating costs remain substantially the same.

The Public Utility Commission was quite conscious of the increased earnings of certain of these companies and the conditions they will face after the war. In a recent public policy announcement the Commission called attention to the fact that the demands of the war had created an artificial economic situation, resulting in some cases in large earnings. It warned that these earnings were not to be used to increase dividends and salaries, but should be impounded to provide funds for the rehabilitation of properties after the war and to prevent rate increases.

Under the Act of 1931 bus companies receive a credit (against the state gross receipts tax) of excise taxes and fees, paid to cities. This is a burden, which is not imposed on such business, operating in a borough or township,[21] nor on motor freight transportation business.

[21] Section 723 of the Vehicle Code, May 1, 1929, P. L. 905, as amended July 16, 1935, P. L. 1056, provides—"No city, borough, incorporated town, township or county shall require or collect any registration or license fee or tax for any motor vehicle, trailer or semi-trailer, or license from any operator thereof, except that cities may levy a fee or tax upon motor buses and motor omnibuses transporting passengers for pay or hire within the limits of any city, or from points within such city to its suburbs which are within a radius of ten miles."

The distinction, made by the Vehicle Code between cities and other municipal units, is wholly artificial. Some first class townships and boroughs have larger populations than some cities and, presumably, furnish more bus business. In at least some cities, the excise taxes, locally imposed, are measured by gross receipts and the taxes, so imposed, are greatly in excess of a state tax on gross receipts. In the case of one company, gross receipts taxes, paid to a city, are more than three times an eight mill tax on gross receipts of the company. A bus company, operating in a borough or township of 30,000 population, thus has a distinct local tax advantage over one, operating in a city of 15,000 population.

Other forms of transportation, such as railroads, are required to maintain their own rights-of-way and receive no credit against taxes, paid for the cost of providing and maintaining the same. Motor transportation pays registration fees to the Commonwealth for the use of the public highways, which are provided for them. These fees must be viewed as part of the industry's share of the cost of building and maintaining the highway system, which provides for it a right-of-way.

However, in addition to registration fees, the motor industry is called upon to pay the tax on liquid fuels, which now amounts to five cents per gallon for state and federal purposes, the state tax being in most part used for highway purposes. A study of a number of companies reveals that the burden of this tax varies greatly. It has been ascertained that, measured by gross receipts, the state and federal liquid fuels tax expenditures run from 1½ percent in the cases of taxicab companies to 7.15 percent in the case of interstate trucks. Some bus companies place this percentage as low as 2 percent, while in the case of other companies the cost runs to 5¼ percent. As gross receipts decline after the war, particularly in the case of bus companies, the percentage burden of this liquid fuels tax will increase, because the same number of miles are travelled by the vehicle. The variation in liquid fuel costs is in part accounted for in the miles, travelled to earn a given amount of gross receipts, the liquid fuels consumed by a particular vehicle, and the topography of the district of operation.

In addition to this liquid fuels tax, the incorporated motor business, of course, also pays capital stock and corporate net income taxes to the state.

The "platform" expense of bus companies, like others engaged in the transportation of passengers, is very high. Salaries and wages of all bus companies, having receipts over $50,000 annually, were in 1942 $34,410,000, while the gross receipts were $64,586,000.

The high taxes on liquid fuels are required to pay the cost of completing the construction of the highway system, which, of course, is shared by everyone operating a motor vehicle.

In view of the differentials, imposed on the bus industry through city excise taxes and the certainty that this business will decline materially in the postwar period, it is deemed unwise to change the present tax act as to passenger transportation by removing the exemptions which now, in most cases, eliminate any gross receipts tax. Since no revenue is now derived from this business, the act of 1931 should be repealed as to passenger transportation.

However, motor freight transportation has been a constantly increasing and profitable business and there is every evidence that this trend will continue in the postwar period. This business is in serious competition with railroads, which are required to pay the gross receipts tax and maintain their own rights of way. There is, consequently, no economic justification for placing motor freight transportation business in a preferred tax class. It, therefore, appears that the exemptions, granted as offsets against the gross receipts tax to motor freight transportation, should be removed.

Unincorporated motor transportation also has a distinct competitive advantage over the incorporated business in that it pays no capital stock or corporate net income taxes. Therefore, in considering this industry, provision should be made in any tax on unincorporated business to include the unincorporated motor transportation business.

Electric light and power companies are subject to the gross receipts tax and, in addition thereto, pay the capital stock and corporate net income taxes. Municipalities, engaged in furnishing electric energy, are exempt from the tax, except on so much of their receipts as are derived from customers, residing outside the territorial limits of the municipality. The same reasoning for the taxation of municipalities on receipts from all electric energy, furnished within and without its limits, applies, as heretofore given, for the taxation of the receipts of municipally owned and operated water plants.

Rural electric co-operative corporations, which are private enterprises, are not subject to any of the taxes, paid by the private electric light and power companies. There is clearly no valid defense for such exemption. They are private companies, engaging in competition with taxed business. They serve consumers in the charter territory of the taxed and regulated utilities. While the companies, presently operating in Pennsylvania, do not generate electricity, but purchase current from private companies, they have the legal power to erect and operate generating plants. In the case of co-operatives, some revenue is presently derived indirectly as the result of their operations. Private companies, which sell energy to co-operatives, are required to pay the gross receipts tax on the revenue, derived from such sales, but the tax here is on the revenue, derived from wholesale sales, while in other cases the tax is on the revenue from retail sales of energy. The gross amount, paid by co-operatives to taxed utilities for energy in 1942, was $321,241,000. This energy was in turn resold by the co-operatives at retail for $1,216,159,000. The Commonwealth received only about one-fourth of the tax, which it would have received, had this energy been furnished directly to the consumers by private, regulated companies rather than by co-operatives. The same reasoning, of course, applies with equal force to the electric utilities, operated by municipalities.

Under the act, incorporating rural electric co-operatives, they are required to pay an annual tax of $10.00 for each 100 members. The amount, realized from this tax in the biennium 1941-1943, was only $5,000. A tax of 8 mills on gross receipts should yield about $19,400 in a biennium.

It is suggested that municipalities and rural electric co-operative corporations be subjected to the gross receipts tax on their electric energy business to eliminate unfair competition and that the membership tax on rural co-operative corporations be repealed.

The gross receipts tax is discriminatory in certain respects. With one exception, the tax is imposed on gross receipts, derived from a primary service, furnished by the taxed company as, for instance, receipts from telephone and telegraph messages or transportation services; but in the case of electric light and power, water power, and hydroelectric business, the tax is imposed on the receipts of the company's business.

It is believed that the legislative intent was to impose the tax only on the primary service, rendered by the company, and not on extraneous receipts. In the case of light and power companies the extraneous receipts result principally from the sale, installation, and repair of electric appliances and equipment. No vendor or electrical contractor is subject to a tax on gross receipts. It is recommended that this discrimination be removed.

Some doubt exists as to the proper act under which the gross receipts tax is imposed on express companies. Such companies are enumerated in section 23 of the Act of 1889, as amended, and there is also a special act, applicable to these companies, enacted in 1899.[22] The report form, furnished by the Commonwealth, refers to the Act of 1899. This confusion should be avoided by repeal of the Act of 1899.

The gross receipts tax act should be amended and restated so as to simplify its language. Amendments, added from time to time, have resulted in a single taxing sentence of more than 500 words. Other matters regarding this tax, which need correction, are the simplification and unification of report forms and provision for annual, rather than semi-annual, payment of the tax. These are matters, which should be corrected by administrative changes in the law.

Recommendations:

1. That the utility gross receipts tax be retained as a tax in lieu of a local tax on real estate and that it be changed to a state tax dedicated to the public school system.

2. That the 23rd section of the Act of 1889 be extended so as to include the taxation of gross receipts of private water companies.

3. That the act be extended to include the taxation of all gross receipts, derived from municipally owned and operated utilities, both water and electric.

4. That the act be extended to include the taxation of all gross receipts, derived from municipal authority-owned and operated water systems.

5. That the act be extended to include gross receipts of rural electric co-operative corporations and that the present tax, payable by such companies, of 10 cents a member, be abolished.

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22 April 28, 1899, P. L. 72.

6. That the Act of 1931, imposing a gross receipts tax on motor transportation, be limited to motor freight transportation business and that the existing exemptions, allowed as offsets against the tax, be eliminated.

7. That the act be amended to limit the tax on electric light and power, water power, and hydroelectric companies to receipts from the sale of electricity.

8. That the Act of April 28, 1899, P. L. 72, relating to express companies, be repealed.

9. That language of the gross receipts tax act be simplified by amendment and that the tax be paid annually instead of biennially.

10. That unincorporated motor transportation business be subjected to a tax on net income.

BIENNIAL TAX COLLECTIONS

TAX ON GROSS RECEIPTS OF PUBLIC UTILITIES

Biennium	*Amount* (in thousands) *Normal*	*Emergency*	*Total*	*Percent of Total Taxes*	*Average State Income* (in millions)
1923-1925	$8,323	....	$8,323	6.02	$6,149
1925-1927	8,992	....	8,992	5.62	6,356
1927-1929	8,552	....	8,552	4.57	6,587
1929-1931	6,973	....	6,973	2.87	6,775
1931-1933	7,517	....	7,517	3.43	4,773
1933-1935	6,190	....	6,190	3.17	4,216
1935-1937	6,561	$4,362	10,923	2.92	5,046
1937-1939	6,045	8,708	14,753	3.57	5,416
1939-1941	6,525	9,546	16,071	3.86	6,052
1941-1943	7,773	11,541	19,314	4.13	8,075
1943-1945[1]	8,416	9,336	17,752	3.84	10,076

[1] Actual and estimated.

The receipts from the *normal* taxes on the gross receipts of public utilities show no correlation with state income. Biennial revenues from normal taxes on gross receipts were largest from 1923 to 1929, with a peak of $9.0 million in 1925-1927. Biennial revenues from the *normal* gross receipts tax decreased irregularly thereafter to a low of $6.0 million in 1937-1939. In 1941-1943, the biennium with the highest state income to date in the Commonwealth's history, normal tax receipts amounted to only $7.8 million.

It may be that the factor, which has brought about this decline, was the loss of freight and passenger traffic by railroads to motor transportation and the complete exemption of passenger street railways from this tax. If railroad revenues of 1936 are taken as a base of 100, it appears that railroad revenues in 1942 rose to 132 but, on the same base, they were 155 in 1923. Railroad revenues in 1942 were, therefore, less than in 1923. In the meantime, while motor transportation has been subjected to the tax, the credits granted are so liberal as to produce little revenue from this source.

Taking all factors into consideration, this tax is fairly stable, but has reacted to economic factors in a manner unusual to other taxes, based on volume of sales.

CHAPTER 10

LIQUID FUELS TAX

The liquid fuels tax, which is a selective sales tax, was first imposed in 1921[1] at the rate of one cent per gallon. By successive enactments, discussed elsewhere, the "permanent" tax has been raised to three cents per gallon, although between May 1, 1929 and July 1, 1930 an additional temporary tax of one cent was effective, and since July 1, 1935 an additional emergency tax of one cent per gallon has been imposed. With the exception of the moneys, derived from the emergency levy, the entire proceeds of this tax have been devoted exclusively to the construction and maintenance of roads and costs incident thereto.

It is a basic principle of taxation in the Commonwealth and elsewhere generally that the yields of special taxes, imposed upon limited groups for the benefit of such groups, should be devoted exclusively to the purposes, for which such revenues were intended. The use made of this tax until 1935, therefore, strictly accorded with this principle.

Since the tax was first imposed, the revenues have been shared by the state and the local units of government. One-half cent per gallon of the tax has always been remitted by the state to the several counties for road construction and maintenance and for the amortization of bonds, issued for road purposes. In addition, in recent years biennial appropriations, amounting to as much as $8,500,000.00, have been made to second class townships for road purposes. This appropriation, which for the 1943-1945 biennium was reduced to $7,000,000.00 because of curtailed construction, due to the war, has been made out of the Motor License Fund, into which the state's share of the tax fund is required by law to be paid.

The one-half cent of the tax, remitted to the counties, was distributed by the Act of 1931 on the basis of the average amount, returned to each county during the three preceding years, and this provision has since remained unchanged. Prior to 1931, when the tax was collected through retail dealers, the tax was distributed each year to the counties on the basis of the percentage of tax collected therein.

Prior to 1931 the tax was collected from the dealers in liquid fuels,

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[1] Act of May 20, 1921, P. L. 1021.

who sold this commodity to ultimate consumers. This system complicated administration, because it required the auditing of a great number of tax reports. In practice it led to a widespread evasion. In 1931,[2] when the act, under which the tax is currently imposed, was passed, it was provided that the tax should be paid over to the state by distributors. The term "distributor" is elaborately defined in the act, but in practice it generally means the manufacturer or importer of liquid fuels, practically all of whom sell the commodity for resale. This system has greatly simplified the administration of the tax, for it has reduced to 325, the number of persons making reports and paying over the tax to the Commonwealth.

The tax is imposed upon the sale or use of liquid fuels in the Commonwealth and it is passed on to the ultimate consumer, upon whom the burden of the tax rests. Distributors, however, are responsible to the state for the collection and remittance of the tax.[3]

In general, the tax statute is satisfactory, although the definition of liquid fuels does not take into account recent advances in refinery processes and engine design. This statute, however, is adequate, if intelligently administered. It should probably be revised during the postwar period, when presently contemplated technological changes have been perfected.

Practically the only difficulties, which have arisen in the operation of the act, have had to do with the audit of the liquid fuels tax reports. These reports can only be verified by checking them against the distributor's purchases and receipts of liquid fuels, which do not coincide with his sales or use because of factors of evaporation, shrinkage, and other handling losses. It is believed that intelligent administration of the existing provisions of the statute will obviate most of these difficulties and that the statute does not require amendment in this particular.

From time to time it has been proposed that liquid fuels, used otherwise than in motor vehicles, operated on the highways, particularly those consumed in the operation of farm machinery, should be exempted from the tax. This proposal has been consistently opposed by those, charged with the administration of the statute, on the ground

[2] Act of May 21, 1931, P. L. 149.
[3] Act of July 2, 1937, P. L. 2774.

that it would lead to evasion. The experiences of other states is cited in support of this position. Although the proposal has certain equitable aspects, this defect, compared with the small amount of tax involved, would seem to make it undesirable. The proposal may also involve constitutional difficulties.

As is indicated above, the use of liquid fuels tax revenues for general purposes violates an accepted principle of taxation in the Commonwealth. For this reason the additional one cent emergency tax, imposed in 1935 and since then paid into the General Fund, should be repealed. However, if its retention is determined, the revenue should be devoted to road construction and maintenance.

The present system of distributing a share of tax to counties is undesirable. The great bulk of local road expenditures is made by the cities, towns, boroughs, and townships of the state rather than by the counties. Whatever distribution is made to defray local expenditures should be given to these subdivisions and not to the counties, many of which cannot now expend the revenue for the purposes to which it is dedicated. Such counties in turn reallocate the revenue to local subdivisions (not always on an equitable basis), which may expend the moneys for road purposes. The diversion of this revenue from counties, which still have outstanding road bonds, or continue to maintain some county road system, or are responsible for the maintenance of county bridges, will not prove a hardship, if other revenues are provided in lieu thereof.

Furthermore, under sound tax practices the portion of the tax, devoted to local expenditures, should not be remitted in the form of a state subsidy, as it is under the present system. That portion of the tax should be imposed as a local tax, although state-collected. The use of such a revenue should be restricted by the tax act to accord with the principle, heretofore stated, as applicable presently to counties.

The diversion of the one-half cent tax, now going to counties, and the elimination of the separate appropriation from the Motor License Fund to townships of the second class, which amounts to about one-quarter of a cent per gallon, would provide three-quarters of a cent tax per gallon for municipalities, to which should be added another quarter cent, now going to the Motor License Fund for state highway purposes. This action would make available to political subdivisions a one cent per gallon tax, yielding presently $28,000,000.00, and in normal times $32,000,000.00, per biennium for road purposes.

While total expenditures by municipalities for roads and road debt purposes are presently unavailable, it is not believed such a revenue would be out of line, or appreciably out of line, with a sound policy of financing the proportion of total road costs, which should be borne by highway users. Furthermore, it is the most logical existing tax for dedication to municipalities in relief of real estate taxation.

The present system of distribution to counties is hopelessly antiquated. In effect, it distributes the counties' share of the tax on the basis of the proportionate amount of liquid fuels tax, collected in each county during the years 1928, 1929, and 1930, which would not be a suitable formula for application to municipalities. A more reasonable and less static system of distribution is one, determined by (a) the mileage of roads, other than state highways, in the various municipalities, and (b) the population of such municipalities. This basis is suggested for the division of the tax among municipalities.

Recommendations:

1. That the liquid fuels tax be retained as a state and municipal tax, the municipal portion thereof to be state-collected.

2. That the rate of liquid fuels tax be reduced to 3 cents per gallon.

3. That 2 cents of the tax be paid into the Motor License Fund and be devoted to the purposes, now provided by law for that fund.

4. That 1 cent of the tax be distributed to the cities, boroughs, towns, and townships of the Commonwealth, on the basis of population and road mileage, for road maintenance and construction and for amortization of indebtedness, incurred for road purposes.

5. That the present biennial appropriation for road maintenance, made to second class townships, be discontinued.

BIENNIAL TAX COLLECTIONS

LIQUID FUELS TAX

Biennium	*General Fund* (in thousands)	*Motor License Fund* (in thousands)	*Liquid Fuels Tax Fund* (in thousands)	*Total All Funds* (in thousands)	*Percent of Total Taxes*	*Average State Income* (in millions)
1923-1925	$11,792	......	$4,308	$16,100	11.6	$6,149
1925-1927	1,806	$15,446	5,767	23,019	14.4	6,356
1927-1929	7,771 [1]	35,739	2	43,512	23.3	6,587
1929-1931	33	56,895	9,614	66,542	27.4	6,775
1931-1933	......	53,075	10,566	63,641	29.0	4,773
1933-1935	......	53,889	10,764	64,653	33.1	4,216
1935-1937	22,380	63,134	12,620	98,134	26.3	5,046
1937-1939	27,832	69,912	14,092	111,836	27.1	5,416
1939-1941	30,761	76,832	15,318	122,911	29.5	6,052
1941-1943	28,137	70,369	14,072	112,578	24.1	8,075
1943-1945 [2]	22,595	56,499	11,298	90,392	19.6	10,076

[1] Counties' share of liquid fuels tax deposited in General Fund in this biennium.
[2] Actual and estimated.

The biennial receipts from the tax on liquid fuels show wide variations in relation to state income, which are not generally characteristic of consumption taxes. Even if changes in the tax rate are taken into account, fluctuations of state income have had only a minor effect upon the growth of liquid fuels tax revenue. The chief cause of increasing revenues has been the constant expansion in the use of motor vehicles and liquid fuels, which has been a consequence, except in the current war years, of mechanical improvement and sales promotion, rather than general economic conditions. With the return of more normal conditions after the current war, the consumption of liquid fuels will probably show a decided increase above prewar levels, with further growth in the amount of liquid fuels tax revenues.

In contrast to other consumption tax revenues, those from the liquid fuels tax showed a decrease, instead of a sharp increase, in 1941-1943, due to the effects of wartime restrictions on motor vehicles and fuels. The liquid fuels tax, however, appears the most likely consumption tax to establish and maintain a level of revenue after the war, substantially higher than its wartime experience.

CHAPTER 11

CIGARETTE TAX

The sale of cigarettes in Pennsylvania was first subjected to an "emergency" tax for a two year period in 1935.[1] Since then, the taxing statute has been re-enacted every two years. The current act, passed in 1943,[2] will expire by its own limitation in 1945.

The tax, which is a specialized sales or consumption tax, is imposed at the rate of one cent upon each sale of ten cigarettes or fraction thereof. Its payment is evidenced by a stamp, affixed to the cigarette package. The statute has been exceedingly easy to enforce because of a statutory provision, permitting the tax to be paid and the stamps to be affixed by manufacturers, both in and out of the state. This provision in conjunction with the relatively small amount of tax, payable on each sales unit, has also proved a practical deterrent to counterfeiting of the stamps, although a few instances of this activity have been discovered. Counterfeiting, however, has not had, and is extremely unlikely to have, any appreciable effect upon the revenues from the tax.

Some evasion of the tax has resulted from the purchase of cigarettes by Pennsylvania consumers from sources in other states, in which no cigarette tax is imposed. Although cigarettes are more easily shipped from place to place than most commodities, and, hence, lend themselves to this form of evasion, its effect upon the total revenues from the tax is believed to be inconsequential. However, at the meeting of the National Tobacco Tax Conference in Harrisburg, Pennsylvania, on September 14, 1944 it was decided to seek federal legislation, permitting the states to exercise the same control over the interstate shipment of cigarettes as they now enjoy with respect to liquor. This action, although it evidences the desire of tax administrators to perfect the administration of the tax as much as possible, is not, under the circumstances, any reflection upon the general efficiency of the tax.

The revenues from this tax have been very substantial and have progressively increased each biennium since the tax was first enacted. The trend, however, is probably due in large part to the increase in

[1] Act of June 14, 1935, P. L. 341.
[2] Act of May 7, 1943, P. L. 209.

number of cigarette smokers and in increased consumption by the individual. Although completely definite conclusions are impossible because of the limited experience of the state with this tax, it seems to be characterized by remarkable stability and is singularly unaffected by economic conditions. This tax is found in 31 of the 48 states.

Recommendation:

That the cigarette tax be made a permanent state tax.

BIENNIAL TAX COLLECTIONS [1]

CIGARETTE TAX

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Average State Income* (in millions)
1935-1937	$19,508	5.22	$5,046
1937-1939	22,450	5.43	5,416
1939-1941	24,394	5.85	6,052
1941-1943	27,516	5.88	8,075
1943-1945 [2]	29,665	6.42	10,076

[1] Full discussion of biennial collections appears in the above discussion of the cigarette tax.
[2] Actual and estimated.

CHAPTER 12

LIQUOR SALES TAX (10 PERCENT)

In 1936 [1] an emergency tax of ten percent was imposed upon the net price of all liquor, sold through the State Stores. The tax was made collectible by the Liquor Control Board. The tax has been re-enacted at each subsequent regular session of the legislature, but it is still a temporary levy which, unless re-enacted again, will expire in 1945.[2]

This tax presents no enforcement problem whatsoever and requires a minimum of administration. Furthermore, it yields a very substantial revenue.

The suggestion has been made that the tax be eliminated and the revenue, which it produces, be secured from an additional mark-up on liquor, sold through the State Stores. As this would involve considerable dislocation of the present merchandising policies and practices of the Liquor Control Board, the suggestion does not appear desirable. So far as the consumer is concerned, it makes no difference whether the liquor he buys is priced at cost plus mark-up plus tax or cost plus a mark-up, which includes the monetary equivalent of the tax. It has also been suggested that this tax be increased and the mark-up of liquor reduced. The rate is now higher than is ordinarily imposed on consumption of goods, except in the case of such taxes as those on cigarettes and liquid fuels, where the tax is not measured by the price, but by quantity or volume. Furthermore, there is no assurance that an increase in the tax would result in a decrease in the mark-up, particularly at times when revenues are desperately needed. The revenues from the tax have proved to be quite stable.

Recommendation:

That the liquor sales tax (10 percent) be made a permanent part of the state's tax system.

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[1] Act of June 9, 1936, P. L. 13.
[2] Act of May 7, 1943, P. L. 207.

BIENNIAL TAX COLLECTIONS

LIQUOR SALES TAX

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Average State Income* (in millions)
1935-1937	$7,290[1]	1.95	$5,046
1937-1939	15,148	3.66	5,416
1939-1941	15,725	3.77	6,052
1941-1943	24,293	5.19	8,075
1943-1945[2]	21,602	4.68	10,076

[1] Approximately one year's collections from June 9, 1936 to May 31, 1937.

[2] Actual and estimated.

The reaction to increasing state income, shown by the consumption tax on liquor sales in the period 1937-1941, closely resembles that of the malt beverage tax, although the increase in liquor sales tax revenues in 1941-1943 was much more pronounced, amounting to about 55 percent. The same conclusions hold for the liquor sales tax, the malt beverage tax, and the cigarette tax. There have been few instances in general experience, when a consumption level, once established, has been diminished solely by short-term fluctuations in state or national income.

CHAPTER 13

MALT BEVERAGE TAX

In 1933,[1] when the sale of malt beverages of appreciable alcoholic content was legalized and it appeared likely that the Eighteenth Amendment (Prohibition Amendment) to the United States Constitution would be repealed, a state tax at the rate of one-half cent[2] per pint of 16 fluid ounces was imposed upon beer, lager beer, ale, porter, and similar malt beverages, containing one-half of one percent or more of alcohol. The tax is imposed on the commodity and is payable by the manufacturer or distributor. (A distributor is defined as including an importer.) Payment is evidenced by a stamp or appropriately lithographed bottle crown. Appropriate provision, however, is made for the exemption from, or refund of, the tax, paid on all beverages, exported from the state for sale elsewhere. Thus, malt beverages, manufactured in Pennsylvania and sold in other states, are not taxed by Pennsylvania, but imports into this state for sale here are taxed.

This tax has proved to be comparatively easy to enforce and has yielded a large amount of revenue. It is a consumption tax, characterized by fair stability, despite changing economic conditions. Despite its large yield, the tax, since it is imposed upon commodities, usually considered to be luxuries, seems to impose no undue or unfair economic burden in any respect.

Recommendation:

That the malt beverage tax be retained as a state tax.

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[1] Act of May 5, 1933, P. L. 284.

[2] The rate was later amended to impose a tax of ⅓c per half-pint by the Act of July 24, 1941, P. L. 477.

BIENNIAL TAX COLLECTIONS
MALT BEVERAGE TAX

Biennium	*Amount* (in thousands)	*Percent Total Taxes*	*Average State Income* (in millions)
1933-1935	$11,262	5.76	$4,216
1935-1937	14,156	3.79	5,046
1937-1939	14,277	3.45	5,416
1939-1941	14,345	3.44	6,052
1941-1943	17,276	3.69	8,075
1943-1945 [1]	21,099	4.57	10,076

[1] Actual and estimated.

The receipts from the malt beverage tax advanced only slightly from 1935 to 1941, although state income increased from an average of $5,046 million for the years 1935 and 1936 to an average of $6,052 million for 1939 and 1940. In 1941-1943, however, malt beverage tax receipts took a sharp upturn, increasing by 20.4 percent over those of 1939-1941, while average state income increased by about 33 percent. The relative importance of the factors, introduced by the war, and the unprecedented wartime rise in state income, in contributing to this increase in malt beverage tax revenues, is uncertain at this time. From the experience of the preceding three biennia, however, it appears that the revenue level of this tax, once it has become established, is likely to continue, despite substantial fluctuations in state income.

CHAPTER 14

SPIRITUOUS AND VINOUS LIQUOR TAX

At the time of the repeal [1] of the Eighteenth (prohibition) Amendment to the United States' Constitution in 1933, three interrelated statutes were passed in Pennsylvania, all of which were designed to derive revenues from the legalized liquor traffic. These were the "Spirituous and Vinous Liquor Floor Tax Law," [2] the "Spirituous and Vinous Liquor Tax Law," [3] and the "Pennsylvania Liquor Control Act." [4]

The first of these imposed a tax of $2.00 a proof gallon (or wine gallon, when below proof) upon all liquors and wines, lodged in the Commonwealth at any time between its effective date and the date of the adoption of the Twenty-first Amendment. The second, as amended, and the one here under discussion, imposed a tax of $2.00 a proof gallon (or wine gallon, when below proof) upon the privilege of selling or using liquors and wines, brought into the state prior to January 1, 1934, and a tax of $1.00 a proof gallon (or wine gallon, when below proof) on the producing, selling, or using of all distilled spirits, manufactured in the state, after the effective date of the act, or brought into it after January 1, 1934. The act also imposed taxes at varying rates upon the production, selling, or using of rectified spirits and wines. The act, however, expressly exempted from tax all liquors and wines, sold to or used by the Commonwealth, the United States, or any one, using the same for scientific, sacramental, or non-beverage purposes, as well as all liquors and wines, shipped for sale outside the state.

The third act, which conferred upon the State Liquor Stores a monopoly of the sale of all liquors and wines in the state, became effective on January 1, 1934. The obvious effect of this act was to render the Spirituous and Vinous Liquor Tax Law practically inoperative because of the exemptions, mentioned above. The relationship between the three acts, however, is apparent. The floor tax imposed a tax upon all liquor and wines in the state, when the repeal of the

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[1] Repealed by the Twenty-first Amendment, proclaimed to be adopted December 15, 1933.

[2] Act of November 22, 1933, Special Session 5, as amended December 22, 1933, Special Session 94.

[3] Act of November 29, 1933, Special Session 15.

[4] Act of November 29, 1933, Special Session 15.

Eighteenth Amendment was imminent. The liquor and wines tax, a purely stop-gap measure, derived revenue from all liquors and wines, manufactured in or brought into the state between the date of the repeal of the Eighteenth Amendment and the date, upon which the State Store monopoly could begin to function. The Liquor Control Act, thereafter, derived revenue from liquors and wines in the form of profits upon sales through the State Stores.

Subsequent to 1933 a small amount of revenue has been received each biennium from the liquor and wines tax. Most of this represents delinquent collections; a small part of it has been derived from illegal importation, for the control of which the Liquor Control Act contains adequate provision. The tax, as a current levy, is obsolete. At one time it was viewed as a substitute revenue producer from liquors and wines, should the State Store System be abolished. This contingency is now exceedingly remote and, if it ever should occur, appropriate substitute measures can be enacted at that time.

Furthermore, it is highly probable that the "Spirituous and Vinous Liquor Tax Law" would be declared unconstitutional, if it were ever tested in the courts. The tax, which it imposes, is similar in every respect, except in amount, to that, attempted to be levied by the "Spirituous and Vinous Liquor Floor Tax Law," and, indeed, prior to January 1, 1934, the two acts purported to levy identical taxes. The floor tax act was held to violate Article IX, Section 1, of the Constitution of Pennsylvania, as lacking in uniformity, as well as the Fourteenth Amendment of the Federal Constitution, as denying due process and equal protection of law.[5] While this tax has been imposed on contraband liquor, brought into the state, the liquor law enforcement agency has no interest in the imposition of the tax. The tax has on occasion been used to hamper prosecution for illegal traffic. The contention has been advanced in such prosecutions that, by payment of the tax and acceptance thereof by the state, the illegal transportation has been legalized. The position is, of course, fallacious, but no doubt has its effect in the ultimate disposal of such prosecutions.

Recommendation:

That the "Spirituous and Vinous Liquor Tax Law" be repealed.

[5] Commonwealth v. A. Overholt & Co., 331 Pa. 182, affirming 45 Dau. 171.

BIENNIAL TAX COLLECTIONS

SPIRITUOUS AND VINOUS LIQUOR TAX

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*
1933-1935	$304	0.16
1935-1937	59	0.02
1937-1939	44	0.01
1939-1941	31	0.007
1941-1943	35	0.007
1943-1945 [1]	43	0.009

[1] Actual and estimated.

CHAPTER 15

INHERITANCE AND ESTATE TAXES

The first inheritance tax ever levied in the United States was imposed by Pennsylvania in 1826.[1] Since that date every other state in the Union, except Nevada,[2] has followed Pennsylvania's example in this respect.

Since 1826 well over fifty statutes have been enacted in Pennsylvania, dealing with various phases of inheritance and estate taxes. The Act of 1826 imposed a 2½ percent transfer tax on collateral inheritances. In 1841 [3] the tax was made collectible by the Registers of Wills in the several counties. The collateral inheritance tax rate was raised to 5 percent in 1846 [4] and in 1849 [5] certain real and personal estates of non-residents were made subject to the tax. In 1850 [6] it was provided that tax on an estate in remainder need not be paid until the remainderman came into possession. In 1887 [7] the collateral inheritance tax laws were codified in a compilation, embracing all prior enactments.

In 1897,[8] for the first time, a transfer tax upon direct inheritance was attempted. The statute, however, exempted from its provisions all estates under $5,000.00 and was held to be unconstitutional [9] as a violation of the uniformity clause of the Constitution of the Commonwealth. In this connection the Court sanctioned the long existing "widows' exemption", on the ground that this exemption was first enacted in 1826, prior to the adoption of the Constitution of 1874, and was continued thereafter by the compilation of 1887. No further attempt was made to tax direct inheritances until 1917,[10] when a 2 percent tax was enacted. This tax did not apply to the so-called "widow's exemption", and its constitutionality was upheld.[11]

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[1] Act of April 27, 1826, P. L. 227.

[2] Inheritance and Estate Taxes were prohibited in Nevada by a 1942 constitutional amendment.

[3] Act of March 22, 1841, P. L. 99.

[4] Act of April 22, 1846, P. L. 489.

[5] Act of April 10, 1849, P. L. 571.

[6] Act of March 11, 1850, P. L. 170.

[7] Act of May 6, 1887, P. L. 79.

[8] Act of May 12, 1897, P. L. 56.

[9] Cope's Estate, 191 Pa. 1.

[10] Act of July 11, 1917, P. L. 832.

[11] Hildebrand's Estate, 262 Pa. 112 (Following Cope's Estate, *supra*).

In 1919 [12] the direct and collateral tax laws were incorporated into a single act, in which the rate upon the transfer of direct inheritances was fixed at 2 percent and collateral inheritances at 5 percent. In 1921 [13] the rate of the collateral inheritance tax was raised to 10 percent.

In 1925 [14] reciprocal inheritance tax legislation was enacted. This statute provided that "personal property of a non-resident decedent made taxable under this section shall not be subject to the tax so imposed, if a like exemption is made by the laws of the state or country of decedent's residence in favor of residents of this Commonwealth."

In 1927 [15] an additional transfer tax was imposed in certain instances in order that the state might receive the benefit of the so-called 80 percent credit, allowed against the federal estate tax [16] for inheritance and estate taxes, paid to the several states. This additional tax was denominated an estate tax, as distinguished from a transfer inheritance tax, in 1929.[17] Since, as a result of this enactment, the tax received by the state is a portion of the federal tax, where the latter exceeds the normal tax, due Pennsylvania and other states, its effect is to collect tax on a graduated basis for the reason that the federal tax is on that basis. The act, however, was upheld,[18] despite the otherwise strong pronouncements of the Pennsylvania courts against graduated taxes.

In 1929 [19] one-half of all jointly held property, except by husband and wife, was made taxable, despite right of survivorship. Also in 1929 [20] it was provided that any transfers, made within one year prior to the death of the transferor without adequate consideration, were presumptively deemed to have been made in contemplation of death. No title notice was given of this provision, however, until 1931,[21] when the defect in this respect was corrected.

The transfer inheritance tax of Pennsylvania is now imposed at

[12] Act of July 20, 1919, P. L. 521.
[13] Act of May 4, 1921, P. L. 341.
[14] Act of May 14, 1925, P. L. 717.
[15] Act of May 7, 1927, P. L. 859.
[16] Section 301 (b) of the Federal Internal Revenue Code of 1926 (26 U. S. C. A. 813).
[17] Act of May 16, 1929, P. L. 1782.
[18] Knowles' Estate, 295 Pa. 571.
[19] Act of May 16, 1929, P. L. 1795.
[20] Act of May 16, 1929, P. L. 1795.
[21] Act of June 22, 1931, P. L. 690.

the rate of 2 percent on direct inheritances and 10 percent on collateral inheritances, except in those cases, where the tax so computed, plus death taxes, payable to other states, is less than 80 percent of the federal tax, imposed by the Internal Revenue Code of 1926. In these cases an additional estate tax, to take full advantage of such 80 percent credit, is imposed.

In the case of resident decedents, the tax is collected by the several Registers of Wills. However, in the case of non-residents, it is collected by the Department of Revenue. Likewise, in the case of non-residents, intangible personal property is not taxed, if a similar exemption is granted Pennsylvania decedents by the state or country of domicile of the non-resident. In all cases, that portion of the tax, imposed with respect to remainder interests, is not payable until the remainder vests in possession.

The transfer inheritance tax is not a tax, assessed upon the estate of the decedent, but is "a restriction upon the right of acquisition by those, who, under the law regulating the transmission of property, are entitled to take as beneficiaries without consideration." [22] The tax is upon the "net succession to the beneficiaries and not on the securities in which the estate of the decedent was invested." [23] The estate tax, on the other hand, is imposed upon the estate of the decedent, because it is derived from the federal tax, which is so imposed.

In the past a very substantial percentage of the state's revenues has been derived from the inheritance tax. This was especially true after 1927, when the estate tax was added to the levy. However, after 1935 revenues from this source have become relatively less important.[24] This was largely due to a sharp increase in other revenues after the adoption of the "emergency" taxes in that year—none of which increased the burden of the inheritance or estate taxes. The revenues from inheritance or estate taxes have also shown a declining tendency, the reasons for which have been discussed elsewhere.

Nevertheless, these taxes are, and will continue to be, an important part of the state's tax system. For many years death taxes were exclusively levied by the states, but now the federal government has also

[22] Stroude v. Commonwealth, 52 Pa. 181.
[23] Orcutts' Appeal, 97 Pa. 179.
[24] See table of biennial tax collections, following.

invaded the field. The tax, nevertheless, is considered a more appropriate one for state purposes. This, of course, is practically exemplified by the 80 percent credit provision of the federal law.

In general, the present provisions of the statute are satisfactory It should, however, be clarified in certain respects.

The direct inheritance tax rate applies in the case of property, passing to a certain class of close relatives, but in some respects this class would seem to be artificially limited and in others, not clearly defined. It includes lineal descendants and parents, but not grandparents or other ancestors, who with equal logic should be included. It also includes adopted children, but apparently excludes other relatives, as for example, grandchildren by adoption. It refers to step-children by the dubious phrase "children of a former husband or wife." In one clause "children" is used interchangeably with "lineal descendants born in lawful wedlock," although in a subsequent clause legitimate and illegitimate children are separately treated. Finally, it provides for tax upon the property "of a person dying seized or possessed thereof," which provision would not include property, passing by deed in contemplation of, or to take effect in possession after, death. To overcome these defects the following definition of the class is submitted:

> "Father, mother, husband, wife, lineal descendants, wife or widow of any such male descendants, and step-children, including any relative as aforesaid through adoption and excluding any such relative born out of lawful wedlock except property passing from the mother of an illegitimate child or from any person, of whom the mother is a lineal descendant to such child, his wife, or widow, and passing from an illegitimate child to his mother." [25]

The clear intent of the Act of 1927 is to take full advantage of the 80 percent federal credit. It does not always work this way, because the normal tax on future estates is not presently payable and cannot be anticipated, whereas the statute requires payment of additional estate tax over and above the inheritance tax, "presently due" upon life estates. Equitably, additional estate tax payments should be applied in reduction of any normal tax, subsequently due the Commonwealth.

Furthermore, in computing the additional estate tax, taxes, "due"

[25] C.f. the Intestate Act of 1917 (June 7, P. L. 429).

Pennsylvania and "actually paid" to any other state, are deducted from the maximum federal credit. These words are ambiguous. Do they contemplate only taxes, presently payable and, if so, do they mean before or after the discount for prepayment? Does the expression "actually paid" include taxes, subsequently payable with respect to future interests in the case of another state, whose taxing statute is similar in this respect to that of Pennsylvania? The ambiguity could be resolved by using the words "paid and payable" in both instances.

The Pennsylvania law exempts certain charitable gifts, made by will, for free exhibition within this Commonwealth. However, a similar gift to an otherwise exempt charity, made by deed, following a life estate, was held to be subject to tax as being made in contemplation of death.[26] This illogical distinction should be eliminated.

The taxing statute limits the tax on the estates of non-residents to transfers of real estate and "goods, wares, or merchandise" within the state and of shares or stock of corporations of the state and of national banks, located therein. The quoted clause was long understood to refer only to chattels. However, in 1939 it was construed to include a bond and mortgage, certain mortgage trust certificates, bonds of the United States, and cash, held by a local bank as trustee for a non-resident.[27] Non-residents' holdings of stocks of Pennsylvania corporations and national banks [28] are exempted from tax by the reciprocity statute, but reciprocity does not exist with all states and, of course, the reciprocity statutes are not applicable to all cases, involving intangible property of non-residents. This situation has created great uncertainty as to the taxability of trust accounts, held for non-residents by Pennsylvania banks, and has discouraged the use of Pennsylvania banking facilities by non-residents.

In New York, consonant with a policy of encouraging local banking business, taxation of the property of non-residents was first limited by statute to real estate and tangible personal property, located in that state, and in 1938 a provision to that effect was inserted in the New

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[26] Hermann's Estate, 349 Pa. 230.

[27] Johnson's Estate, 333 Pa. 193.

[28] Such holdings were exempted on constitutional grounds (and the reciprocity statutes were rendered practically obsolete) by First National Bank v. Maine, 284 U. S. 312 (1932), but this decision was overruled by Tax Commission v. Aldrich, 316 U. S. 174 (1941), during which interval some of the reciprocity statutes were repealed.

York Constitution. In order to remove as far as possible the competitive disadvantage, so visited upon Pennsylvania interests, a similar provision should be inserted in the Pennsylvania statute.

In the case where an apportionment proceeding under the Act of 1937 [29] might result in the apportionment of tax liability upon an estate, from which no tax has yet been collected, the Commonwealth would seem to be an interested party to the proceeding. It should receive notice thereof and be given an opportunity to appear.

It has been suggested that the Pennsylvania tax should be graduated, or, at least, in the interest of simplified administration, small estates should be exempted. As has been pointed out, both such proposals could only be accomplished by constitutional amendments; a statutory provision would not suffice.

Recommendations:

1. That the inheritance tax be retained as a state tax.

2. That the language of the statute, defining the class, transfers to which are subject to the direct inheritance tax, be clarified and rationalized, as set forth above, by extending the class to lineal ancestors and to direct descendants, as presently defined, whether by blood or adoption.

3. That the Estate Tax Act be amended by substituting the words "payable and paid" for the word "due," which appears in the first step of the computation relating to the normal Pennsylvania tax, and be substituted for the words "actually paid," which appear in the second computation, dealing with the payment of taxes to other states.

4. That the Estate Tax Act be amended so that any payment, made in order to absorb the 80 percent federal credit in addition to inheritance taxes presently payable, be recognized as a credit against inheritance taxes, later becoming payable.

5. That gifts of property for free exhibition to the public, when made by deed of trust, be given the same exempt status as similar gifts, made by will.

6. That the tax on the property of non-residents be limited to real

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[29] Act of July 2, 1937, P. L. 2762, which adds Section 48.1 to the Fiduciaries Act of 1917.

estate and tangible personal property, located within the Commonwealth.

7. That the Apportionment Act of 1937 be amended to provide that, where an apportionment proceeding would result in an apportionment of tax liability against an existing estate, from which the Commonwealth has not collected its tax, the Commonwealth be entitled to receive notice and have the opportunity to appear as a party litigant in the apportionment proceedings.

BIENNIAL TAX COLLECTIONS
INHERITANCE AND ESTATE TAXES

	Amount (in thousands)			Percent	Average
Biennium	*Transfer*	*Direct and Collateral*	*Total*	*Percent of Total Taxes*	*Average State Income* (in millions)
1923-1925	$23,272	$1,048	$24,320	17.58	$6,149
1925-1927	30,539	951	31,500	19.70	6,356
1927-1929	33,548	1,139	34,687	18.52	6,587
1929-1931	66,342	563	66,905	27.57	6,775
1931-1933	50,903	375	51,278	23.40	4,773
1933-1935	32,950	466	33,416	17.09	4,216
1935-1937	35,493	434	35,927	9.61	5,046
1937-1939	48,961	324	49,285	11.92	5,416
1939-1941	35,906	249	36,155	8.68	6,052
1941-1943	27,944	254	28,198	6.02	8,075
1943-1945[1]	31,765	853	32,168	7.06	10,076

[1] Actual and estimated.

The inheritance tax is, inherently, without definite relation to fluctuations in state income. The increased biennial revenues, received during the period 1923-1931, are attributable to new inheritance transfer and estate taxes, enacted in 1917 and 1927, respectively. There is also a factor of chance in the biennial yields of this tax, since the settlement of an exceptionally wealthy estate will greatly increase the revenue of any one biennium. Although the general irregularity of revenues, apparent in the above table, characterizes this tax, it would seem that heavy federal taxes on income and estates are major causes of the general trend of decline in inheritance tax revenues, evident since peak collections in 1929-1931. The lack of incentives to amass great fortunes and the effects of the federal estate tax are likely to reduce the relative importance of inheritances and estates, as a source of state revenue, for some years to come.

CHAPTER 16

PERSONAL PROPERTY TAX AND CORPORATE AND MUNICIPAL LOANS TAXES

Since the county personal property tax, on the one hand, and the state corporate and municipal loans taxes, on the other, are complementary, and since, until very recently, all these were imposed by a single statute,[1] it is desirable that they be considered together. All three taxes are imposed at the rate of four mills upon various types of intangible personal property in the hands of the holders or owners thereof. The basic difference between them is that, in the case of the county personal property tax, the taxable property is reported and the tax is paid directly by the owner, whereas, in the case of the other two, the tax is reported and paid "at the source" by the corporation or municipality issuing, assuming, or paying interest upon obligations of various sorts. In these cases, however, the tax is theoretically borne by the owner, for it may be deducted at the source from the interest paid on the obligation.

A second difference is that since 1913 the personal property tax, always county collected, has been devoted to county purposes, while the corporate and municipal loans taxes have always been state collected and used for state purposes.[2] A third difference is that, while all three taxes are imposed upon the value of the property, as distinguished from the income therefrom, corporate and municipal loans taxes are calculated upon the principal sum of the obligation taxed, whereas the personal property tax is computed upon the actual value of the property subject thereto. Although this distinction would seem to be discriminatory, its constitutionality has been upheld.[3]

A tax was first imposed by Pennsylvania on personal property in

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[1] Act of June 17, 1913, P. L. 507.

[2] By the Act of June 22, 1935, P. L. 414, the state imposed a temporary tax of 1 mill for state purposes upon the property, already taxed at 4 mills under the "County Personal Property Tax Act," and at the same time temporarily increased the corporate loans tax to 5 mills. No increase was provided in the rate of the municipal loans tax. By the Act of July 17, 1936, P. L. 51, the state Personal Property tax was increased to 4 mills and the corporate loans tax to 8 mills. These provisions were successfully re-enacted, but both expired by their own limitation in 1943. They are, therefore, not a part of the present state and county tax systems and need not figure in this discussion.

[3] Delaware Division Canal Co. v. Commonwealth, 123 Pa. 594.

1831.[4] In that act the enumeration of taxable property included tangible as well as intangible personal property. Since that date, except for the period from 1836 to 1840, personal property of various sorts has always been subjected to tax.

In 1844 municipal loans were first classified separately from other personal property and taxed "at the source." Through successive enactments this tax has remained substantially unchanged[5] in principle, although assessed at varying rates. This tax has always been reported to, and assessed and collected by, the state for state purposes.

Loans of private corporations were first made a separate subject of taxation in 1864,[6] although prior[7] thereto certain railroad bonds were taxed. The separate classification of corporate loans for tax purposes was abolished in 1874,[8] but was re-established in 1879.[9] The revenues of this tax have always been devoted to state purposes.

All three taxes were imposed by the Tax Act of 1889[10] and were again separated from other state taxes in 1913.[11] In this act, for the first time, the personal property tax was made purely a county tax.[12] The principal reason for this was that the City of Philadelphia was unable to finance badly needed transit facilities, because the amount of its outstanding bonds approached the constitutional limit of 7 percent of its assessed values for local taxation. The addition of the assessed value for personal property tax purposes to the real estate valuations relieved this situation.[13]

The first sixteen sections of the Act of 1913 provided for the imposition, assessment, and collection of the personal property tax. Section 17 imposed the corporate and municipal loans taxes, but the language of Sections 1 and 17 overlapped, so that, in certain instances, both taxed the same property, and, in others, property, intended to be

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4 Act of May 25, 1831, P. L. 206.

5 By Act of May 11, 1911, P. L. 236, obligations of school districts, which had not theretofore been considered municipal loans, were included in the municipal loans tax.

6 Act of April 30, 1864, P. L. 218.

7 Under the Acts of April 29, 1844, P. L. 486, and May 1, 1854, P. L. 535.

8 Act of April 24, 1874, P. L. 68.

9 Act of June 7, 1879, P. L. 112.

10 Tax Codification of June 1, 1889, P. L. 420.

11 Act of June 17, 1913, P. L. 507, *supra.*

12 In 1889 provision was made for the return of one-third of the tax to the counties. This was increased to three-fourths in 1891.

13 Elliot v. Philadelphia, 229 Pa. 215 (1910); prior to the 1913 Act, and McGuire v. Philadelphia, 245 Pa. 307 (1914), subsequent to that Act.

included, was, in fact, exempted from tax. Four acts were passed in 1919 to clarify this situation, as follows:

1. Where interest was paid upon corporate or municipal indebtedness during a particular period for a prior year, the appropriate tax for that year should be deducted from the interest, so paid, and should be paid into the state treasury.[14]

2. Taxable corporate and municipal indebtedness was defined to be "all scrip, bonds, certificates and evidences of indebtedness," not only "issued," but also "assumed, or on which interest shall be paid" by any corporation or municipality and such loans were exempted from tax under Section 1 of the act.[15]

3. The machinery of collection of the corporate loans tax was clarified and compensation, payable to the treasurer of the corporation, was provided for collecting, reporting, and paying over the tax.[16]

4. The corporate loans tax was extended to the loans of foreign corporations, doing business in the state, without regard to whether the treasurer was a resident or non-resident of the Commonwealth.[17] This was declared unconstitutional.[18]

It had theretofore been held that the treasurer of the corporation was the agent of the Commonwealth to collect the tax,[19] but in case of his failure in this respect the corporation was made liable therefor.[20]

The act has been frequently amended since 1919, but all of these amendments, except one, either created further exemptions of a minor nature or refined the provisions relative to assessment and collection. The one exception is the Act of June 19, 1939, P. L. 413, which extended the personal property tax to equitable interests in property, enjoyed by residents of the state, but held in trust outside the state.

From very early times it had been held that corporate loans tax could only be collected from resident bondholders.[21] The personal property tax, of course, was always expressly imposed only upon residents.

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[14] Act of July 15, 1919, P. L. 954.
[15] Act of July 15, 1919, P. L. 955.
[16] Act of July 21, 1919, P. L. 1067.
[17] Act of July 15, 1919, P. L. 958.
[18] Commonwealth v. American Ice Co., 24 Dau. 453.
[19] Commonwealth v. Phila. & Reading R. R. Co., 150 Pa. 312; Lehigh Valley R. R. Co., 104 Pa. 89.
[20] Commonwealth v. Wilkes-Barre & Scranton R. R. Co., 162 Pa. 614.
[21] State Tax on Foreign-Held Bonds, 82 U. S. 179.

In 1937 Section 17 of the Act of 1913, which provided for the imposition of the corporate and municipal loans tax, was repealed and its provisions were re-enacted in the State Personal Property Tax Act of that year.[22] This was done because it was thought at the time that the state tax might become a permanent feature of the state's tax system. Events have proved otherwise and the anomalous situation exists that the personal property tax is now imposed under the provisions of the Act of 1913, while its complements, the corporate and municipal loans taxes, are imposed under the Act of 1937, as re-enacted, the provisions of which, pertaining to the state personal property tax, are no longer in force.

The personal property tax[23] is imposed upon a specifically enumerated list of intangible personal property, held by persons, associations, and corporations, resident or located in Pennsylvania. However, both the property taxed and the holders, liable to pay the tax, are qualified by numerous exceptions.

The following is a summary of the types of property upon which the tax is imposed:

Mortgages

Money, owed by solvent debtors on notes, bills, bonds, and judgments

Agreements and accounts, bearing interest

Public loans, except those issued by the Commonwealth, the United States, and those taxable as "municipal loans" (see infra)

Loans of any other state or government

Loans of any private corporations, except those taxable as "corporate loans" (see infra)

Shares of stock or bonds of corporations, associations, or limited partnerships, except those liable to pay the state a tax on shares or the capital stock-franchise tax

Money, invested outside the state

Moneyed capital, owing to individual citizens of the state

The principal value of annuities, yielding over $200 per year

Equitable interests in personal property of any of the classes enumerated, legal title to which is held outside the state.

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[22] Act of May 18, 1937, P. L. 633.

[23] As last amended by Act of July 29, 1941, P. L. 548, 552, 556.

In addition to the exceptions noted above, the following property is specifically exempted from tax:

Bank notes

Notes, discounted or negotiated by banking institutions

Loans or securities, held by bankers and brokers solely for trading purposes

Accounts, owed to customers by bankers and brokers

Interest bearing accounts in banking institutions and in employes' thrift or savings associations

Property, held in its own right by any banking institution in liquidation or assigned by such institution to trustees for liquidation

Proceeds of insurance policies, held by the insurer

Property, received by any resident from a non-resident and held by the former for the benefit of a non-resident

Shares of stock of building and loan associations

Property, held in trust for a resident, who for the preceding ten years has contributed all income therefrom to charity.

All of the foregoing personal property, held by those, subjected to the tax, is taxable whether it is held:

In the taxpayer's own right; or

As "active trustee, agent or attorney in fact, or in any other capacity," except

(a) As personal representative of a non-resident decedent, or

(b) As trustee for a religious, charitable, or educational organization; or

As trustee jointly with another, who is domiciled outside the state, while the property is held or managed in the state.

Those holders, subject to the tax, are described in the most comprehensive language which, however, is specifically qualified by a number of exceptions:

All persons, partnerships, or unincorporated associations, resident or located in the state, and

All joint stock associations, limited partnerships, banks, and corporations, liable to taxation in Pennsylvania, *Except*

Building and loan associations
Savings institutions, having no capital stock
Fire companies and firemen's relief associations
Mutual life and fire companies
Secret and beneficial societies
Labor unions and their relief associations
Beneficial (sickness and death) organizations
Corporations, liable to a tax on shares or the capital stock-franchise tax.

Subject to exceptions, hereafter noted, each (a) "private corporation doing business in this state and having a resident corporate treasurer therein" and each (b) "county, city, borough, township, school district or incorporated district" in the state is required to report and pay over to the state the corporate or municipal loans tax upon all "scrip, bonds, certificates and evidences of indebtedness," which it has (1) issued, (2) assumed, or (3) upon which it pays interest.[24] The tax may be deducted from the interest, paid the holder of the loan, by the reporting corporation or municipality, or the tax may be assumed by the reporting entity under a covenant with the holder. In neither case is the tax paid over to the state, if no interest is paid on the obligation. This is because the tax is imposed upon the holder and, if no interest is paid to such holder, the machinery for collection "at the source" breaks down.

The act excepts certain types of loans from the tax. These exceptions exactly parallel those in the Personal Property Act, enumerated above, with one somewhat illogical exception. Loans, held by savings institutions, are exempt, unless the issuing corporation or municipality has covenanted to bear and pay the tax, in which event they are taxable.

The act also exempts all loans, held by certain types of holders. These holders are identical with those, not subject to personal property tax, except that (a) mutual casualty insurance companies, in addition to mutual life and fire insurance companies, are "non-taxable" holders for corporate loans tax purposes, and (b) corporations, "liable to a tax on capital stock," are non-taxable corporate loan holders instead

[24] As last amended by the Act of July 11, 1941, P. L. 361.

of those, described in the personal property tax act as liable to a tax on shares or to the capital stock-franchise tax. The former exception (a) would seem to be an inconsistency between the two acts and the latter exception (b) is not important, as both expressions have received the same construction.

Not all corporations are required to report and pay over the tax on their outstanding loans. Those relieved of this duty are:

Non-profit corporations
Building and loan associations
Savings institutions without capital stock
Fire companies and firemen's relief associations
Mutual life, casualty, and fire insurance companies
Beneficial societies and associations
Labor unions and their relief associations.

No municipalities, as such, are excepted, but municipal authorities, which are instrumentalities of municipalities, are exempted in the manner hereinafter set forth.

Certain other loans have been exempted from the personal property, corporate, and municipal loans taxes by provisions in other statutes and by court decisions.

Credit unions have been designated "institutions of savings." [25] They are, therefore, neither liable to the tax on their own holdings nor are they required to pay over the tax on loans, issued or assumed by them and held by others.

Third class cities [26] and boroughs [27] are not required to assess and report the municipal loans tax upon bonds, issued by them to acquire water systems, and such bonds are not taxable in the hands of their holders.

The bonds of municipal authorities are exempt from the tax.[28]

The holdings of rural electric co-operative corporations are exempt from the tax.[29] Loans, issued by them, do not seem to be exempted, but the point is academic because in practice they borrow

[25] Section 23, Act of May 26, 1933, P. L. 1076.
[26] Section 3522, Act of June 23, 1931, P. L. 932.
[27] Section 2422, Act of May 4, 1927, P. L. 519.
[28] Section 15, Act of June 28, 1935, P. L. 463.
[29] Section 31, Act of June 21, 1937, P. L. 1969.

their funds from the Federal Rural Electrification Administration, the holdings of which are exempt.

Finally, personal property, held by first class or non-profit corporations in their own right, is exempted from personal property, municipal, and corporate loans taxes by a long line of court decisions.[30] Loans, issued by these corporations, however, are subject to personal property tax in the hands of their holders.

The statutory provisions, by which both the personal property tax and the corporate-municipal loans taxes are imposed, are compositional atrocities. Both grew to their present state by accretions over the years. Since literally every phrase of both provisions has been construed by the courts, there has been some reluctance to modernize their obsolete verbiage. They are, however, verbose, repetitious, and, in some instances, inconsistent. Furthermore, they lack any semblance of logical arrangement. Both could be greatly shortened and clarified, if redrafted in paragraph form, and if, in the process, advantage were taken of the rules and definitions of the Statutory Construction Act.[31] In addition, many of the exceptions, both as to property taxed and holders subjected to tax, could be combined and more accurately phrased. All of this could be done without serious risk of vitiating the decisions, in which the former law has been construed.

The designations of the property taxable and the exceptions thereto, as well as that of the identity of the taxable holders, are not as clear as they might be in both the personal property and the corporate-municipal loans tax statutes. The statutory provisions should be clarified and certain inequities eliminated in the following particulars:

1. The imposition of tax upon the principal value of annuities, yielding over $200.00 per year, pre-dated the Constitution of 1874 and is, therefore, probably valid, although it does not conform to that uniformity, required of tax statutes, first enacted subsequent to the Constitution. Actually, there is little practical difference between annuities and the proceeds of insurance policies in the hands of insurers and in many instances even the legal difference is by no means clear. Generally speaking, the holders of "annuities" and the recipients of insurance proceeds, periodi-

[30] See General Assembly v. Gratz, 139 Pa. 497.
[31] Act of May 28, 1937, P. L. 1019.

cally disbursed, are similar in character and circumstances. If public policy is subserved by the exemption of the one, it is equally so with the other.

2. The taxation of loans, containing a "bear and pay" covenant in the hands of savings institutions, while other loans, held by these institutions, are exempt, is an illogical discrimination and should be abolished.

3. Personal property, otherwise taxable, held by credit unions is exempt because these organizations are declared by statute to be "institutions of savings." If credit unions are subjected to the net earnings tax, to which savings institutions are liable, as is suggested elsewhere herein, this exemption is consistent and should be retained. By the same token the holdings of agricultural co-operatives [32] should be exempted, but the present acts contain no provision to this effect.

4. The shares, issued by foreign stock insurance companies, doing business in the state, as well as those of domestic stock companies, should be exempted from tax. The shares of domestic companies are now exempt because these companies are liable to a capital stock tax. However, as is pointed out elsewhere in Part II, this tax, added to the eight mills gross premiums tax, is intended to be equivalent to the two percent gross premiums tax, exclusively imposed upon foreign companies. This view has been accepted by the courts [33] in exempting the shares of foreign companies from taxation. An amendment to the act in 1941, however, compelled the court to change its former decision.[34]

5. Personal property, otherwise taxable, held in Pennsylvania by all insurance companies, stock and mutual, foreign and domestic, should likewise be exempted. The holdings of domestic stock companies are exempted at the present time because they are liable to a capital stock tax. Following the same line of reasoning, applied to shares, issued by insurance companies, the holdings, that foreign stock companies may have in Pennsylvania, should likewise be exempted. The holdings of all mutual companies should be exempted from tax because of the recommendation, made elsewhere herein, that they be subjected to a gross premiums tax.

6. Elsewhere in this Part (II), it is recommended that the gross receipts of municipal authorities and rural electric co-opera-

[32] Held subject to the net earnings tax by Attorney General's Opinion No. 461, June 28, 1943.
[33] Girard Trust Company, Trustees, Appeal, 333 Pa. 129.
[34] Pennsylvania Company, Etc., Trustee Case, 345 Pa. 130.

tives be subjected to a tax, similar to that imposed upon the receipts of privately owned public utilities. The personal property holdings of privately owned utility companies are not taxable because they are liable to the capital stock-franchise tax. Since the competitive situation between these types of organizations is proposed to be equalized by the recommendations, mentioned above, it seems fair to exempt the personal property holdings, if any, of municipal authorities and rural electric co-operatives. However, the bonds, issued by these organizations, in the hands of otherwise taxable holders, should not be exempted and amendments to the act, under which they are created, appropriate to that effect, are recommended. Such amendments probably could not make bonds, presently outstanding, taxable for constitutional reasons, but they could properly be applied to any future issues. In addition, the definition of taxable personal property should be amplified to clearly include these bonds. It is doubtful if they, especially the bonds of municipal authorities, are clearly contemplated under the expressions "public loans" and "agreements bearing interest."

7. The recommendations, hereinbefore made with respect to the holdings of credit unions, co-operatives (agricultural and rural electric), insurance companies, and municipal authorities, as well as with respect to the stock of certain of these organizations, may be accomplished by providing that neither the stock nor the personal property holdings of companies, liable to a tax on shares, the capital stock, the franchise, *the net earnings, the gross premiums or the gross receipts tax* shall be liable to tax. This would permit the elimination of several specific exemptions, now provided for, and would avoid the necessity of enacting additional specific exemptions.

8. Exemption should likewise be extended to companies, "relieved" from the capital stock and franchise taxes. Such a provision was formerly contained in the law to exempt shares, issued by, and the personal property of manufacturing companies and others, exempted from the capital stock tax. It was eliminated with the abolition of the manufacturing exemption. Since legislation has already been enacted to restore the manufacturing exemption, the original language of the law should be restored.

9. Although the language referred to might conceivably be construed to exempt the holdings of first class and non-profit corporations, it is suggested that these companies be specifically exempted, thus enacting the law in this respect, as declared by the courts.

10. All municipal bonds in the hands of taxable holders should be subjected to tax. There is no compelling reason why bonds of third class cities and boroughs, issued to acquire water systems, should be singled out for exemption.

11. The imposition of the personal property tax upon the matured dividend and interest paying shares of building and loan and federal savings and loan associations, elsewhere suggested herein, should be accomplished by specific provision because a possible construction of the expression "relieved" from the capital stock tax might defeat this proposal. The holdings, as distinguished from the shares of these associations, should continue to be exempted by specific provision.

12. It is questionable whether the exemption respecting interest bearing accounts of employes' thrift associations is broad enough to exempt the holdings of employe pension plans, which, because of a recent federal tax exemption, have become rather numerous. By analogy to the exemption of annuities and proceeds of life insurance, these should be exempted.

13. The provisions relative to trusts, created by non-residents for the benefit of non-residents, have been susceptible of strict, and it is believed, unintended construction. The property, exempted in this connection, is described as that "received" by the resident trustee. It has been suggested that the exemption does not extend to reinvestments of the property, originally received. It has also been held administratively that the use of the word "received" freezes the taxability of the trust. It is here suggested that property, held by a resident for the benefit of a non-resident, should be exempted at any time, when the creator of the trust is a non-resident, or after his decease.

In many instances the present law confuses an exception from the definition of property, upon which tax is imposed, with an exception from the class of those, subject to tax. Thus, to cite a single example, it is provided that the act shall not apply to savings institutions without capital stock. The obvious intent is that personal property, normally taxable, should not be subject to tax, when held by these institutions. A possible construction of the provision, however, would exempt interest bearing loans, obtained by savings institutions from, and held by, individuals other than members. This ambiguity, and others like it, should be removed.

The mere process of combining the personal property with the corporate-municipal loans tax provisions, hereinafter suggested, would automatically bring about some clarification in this connection, because such proposed provision would deal only with the property, upon which tax is imposed, and the resident holders, subject to tax; and these two concepts will necessarily be kept entirely distinct.

The personal property tax should be retained as a county tax. In the past there has been agitation against the tax because, like all levies upon capital, it bears little relation either to the income, derived from the property taxed, or the owner's general capacity to pay. When the tax is imposed upon unproductive property, such as defaulted bonds, it obviously works a hardship. But in this respect it does not differ from a real estate tax, imposed upon unproductive real property. So long as holders of real estate are taxed upon the value of their holdings, irrespective of income, derived therefrom, there is no good reason why those, who have invested their wealth in unproductive personal property, should not be similarly treated. In both cases, of course, some relief is obtained from the assessment of the property, taxed at its actual value, in the determination of which consideration should be given, among other things, to the income, derived therefrom.

Two other reasons of a technical nature exist for the retention of the tax.

Since 1913 the personal property tax assessments have been included in the valuation, upon which, under the Constitution, the county borrowing capacity is based. In fact, as has been pointed out, this was the primary reason for making the personal property tax a county tax. While it is not suggested that the abolition of the tax would invalidate any county bonds, presently outstanding, such abolition would diminish the capacity of all the counties to float future loans, and in some cases, particularly in counties like Philadelphia and Allegheny, where real estate assessments have been falling in recent years, it would prevent any borrowing at all for many years to come.

The abolition of the tax would also compel abandonment of the present method of taxing banking institutions. Elsewhere herein the interrelation of the bank and trust company shares tax with the tax upon other moneyed capital is discussed. It is there considered that, because of the federal limitation of state taxation of national banks, no more satisfactory method of taxation of banking institutions could be devised than the present tax on shares and that the continuance of this method was contingent upon the continuance of the personal property tax.[35]

The taxation of corporate and municipal obligations must be retained, if the personal property tax is to continue as a constitutional levy. However, there are convincing reasons why the machinery of the corporate and municipal loans taxes for collecting part of the tax should be abandoned. Basically, there are not three taxes; there is only one, but it is collected by two methods.

By comparison with the personal property tax, the corporate and municipal loans taxes are inequitable, uneconomical, and inefficient. Corporate and municipal loans taxes are calculated on the principal sum or face value of the obligation taxed. No consideration is given to its actual value. A $1,000.00 bond, selling for $500.00 is taxed the same amount as one, which sells for $1,000.00. The tax is also the same, whether the obligation bears interest at the rate of 2 or 6 percent. Taking these figures, for example, the tax on a 2 percent bond is equivalent to a tax of 20 percent on its income, while on a 6 percent bond it is only 6.7 percent on its income. In the absence of any other factors, these two bonds would have a very different actual value and would be subject to a proportionately different personal property tax. Furthermore, if no interest was paid upon an obligation during any given year, it escapes corporate and municipal loans taxes, regardless of its actual worth.

Thus, the corporate and municipal loans tax, as a percent of the income, increases proportionately as the income produced decreases, with the single exception that, when the income decreases to zero, the tax disappears. The unfairness of such a system is apparent. Although this method of taxation has been followed in Pennsylvania for nearly three quarters of a century, no other state has seen fit to adopt it.

Although superficially it would seem that collection "at the source" is an economical and efficient device, it has not proved to be so in the case of the corporate and municipal loans taxes. This is because the identity and residence of the holder of each item of indebt-

[35] See this Part (II), under "Tax on Shares of Banking Institutions."

edness determines whether that item is subject to tax. This circumstance has complicated the administration of the tax, imposed upon the reporting corporations, the municipalities, and the state an almost intolerable burden of detail, and generally made the overall cost of collecting the tax very high.

The treasurer of each corporation and municipality is required to establish and report the identity and residence of each holder of its corporate indebtedness. Unless positive proof is presented of non-taxability, the item is considered taxable, regardless of the diligence exercised in this connection. It is the practice of the state to communicate with a large portion of the holders, which are claimed to be exempt. Many communications go to banking institutions, which may hold the obligations in their own right or act in a fiduciary or agency capacity for others. These are a source of inconvenience and irritation to the banks, especially in states other than Pennsylvania, and many of the responses are unsatisfactory, due, perhaps, to the cost of assembling the necessary data without compensation. Where a Pennsylvania banking institution holds items of indebtedness in a fiduciary or agency capacity, it becomes necessary for it to furnish the Commonwealth with a description of the capacity, in which the obligation is held. Some banks understandably make a charge for services in furnishing this information. If replies from holders, both within and outside of Pennsylvania, are incomplete, inconclusive, or otherwise unsatisfactory, the item upon which exemption is claimed is disallowed. The corporation is then required to produce satisfactory evidence of the exempt status or become liable for the tax. This is the beginning of correspondence between the corporation and the holder, which again becomes a source of expense and inconvenience to both. The experience of a large public utility system, covering a ten-year period ending in 1940, is typical. The state in this instance claimed additional taxes, in excess of the amounts, admitted by the companies, of approximately $200,000.00. After investigating each disallowed item and obtaining and submitting additional data at considerable expense, it was found that only $6,000.00 additional tax was due.

It is even more difficult to ascertain ownership, where the corporation has covenanted to pay the tax rather than to deduct it from interest. In these cases there is no incentive for the holder of the indebtedness to furnish details of ownership and residence. So letters frequently go unanswered.

So far as the reporting corporation is concerned, the allowance of the treasurer's commission, provided for in the act, usually falls far short of compensating for the postage, stationery, and time consumed. In cases of large bond issues, the treasurer's commission scarcely pays the cost of typing the schedules, which must be attached to the report. It has been estimated by one large corporation that its expense in assembling information as to holders and in collecting and reporting the tax exceeds 20 percent of the tax, actually paid to the state at the normal rate of four mills. This, of course, does not include the expense to the state in carrying on the operations, outlined above. No figures are obtainable in this connection, but, since the work involved is parallel to that, performed by the corporation, it is probable that the cost likewise is comparable.

Although the taxing officers are current in the settlements of other corporate tax reports, they are, in numerous instances, years behind in settling corporate loans tax reports. This is true only to a somewhat less degree in the case of the municipal loans tax reports.

Furthermore, all this activity has certain aspects of futility. Less than 20 percent of all the loans of private corporations are in taxable hands, although every holder, regardless of identity or residence, must be reported. It is likely that about the same situation exists in the case of municipal loans.

The corporate and municipal loans taxes, therefore, should be abolished and the obligations, taxable thereunder for state purposes, should be subjected to the county personal property tax and taxed for county purposes. Since the corporation and municipal loans taxes are now imposed under the Act of 1937 and, since the section, pertaining to those taxes in the 1931 Act, has been repealed, this recommendation may be carried out by repealing the former act and making appropriate amendments to Section 1 of the latter.

At the same time Sections 2 to 16, inclusive, of the Personal Property Tax Act, which provide the machinery for collection of the tax, should be redrafted to eliminate unnecessary verbiage and to tighten up the enforcement provisions.

Section 16 in particular should be amended. This section declares that all taxes, imposed upon the holder of an obligation, but paid by the borrower, shall be considered usury. The effect of this provision is to invalidate "bear and pay" covenants in corporate and municipal bonds, so far as this could be constitutionally accomplished. As these covenants are quite common, the statute should be so amended as to permit their use in the future. However, the use of this clause would probably disappear under the consolidated tax, here proposed.

If the corporate-municipal loans tax, however, is retained, that provision,[36] by which all items of indebtedness are deemed to be held by residents of Pennsylvania, unless the contrary be shown, should be modified. It is most inequitable and, as has been shown, very burdensome.

The abolition of the corporate and municipal loans taxes and the addition of the loans, taxed thereunder, to the personal property, taxed for county purposes, will not only eliminate the objectionable features of the present system, discussed above, but will also augment the revenues of the counties and increase their borrowing capacities. In this way the counties will be compensated for the loss of the liquid fuels tax revenues, proposed herein to be shifted to the other political subdivisions. The increased revenues from the personal property tax, plus the tax on writs, wills, and deeds, also recommended herein to be dedicated to county purposes, should be sufficient to enable the counties to carry their present road costs, including debt service, and these additional funds will not be restricted to these purposes, as is the case with the liquid fuels tax revenues. The proposal, therefore, will increase the flexibility of county finances.

No accurate estimate of the amount of the additional revenues, which will go to the counties as a result of this proposal, can be made. Because of the various amendments suggested, the past annual yields of the corporate-municipal loans tax is not an accurate criterion for the future and, of course, some decrease may result from careless enforcement by some of the counties. However, the additional revenues should be very substantial, especially since many counties now have placed the collection of the personal property tax on an efficient basis.

[36] Section 18, Act of May 18, 1937, P. L. 633.

Recommendations:

1. That the personal property tax be retained as a county tax.

2. That the corporate and municipal loans taxes be abolished and the obligations, taxed thereunder, be subjected to the personal property tax.

> *That in case the corporate loans tax is not eliminated from the corporate tax structure,* Section 18 of the Act of May 18, 1937, P. L. 633, be amended to eliminate the provision that all items of indebtedness be deemed to be owned by residents of the Commonwealth, unless it is established by the taxpayer to the contrary.

3. That the provisions of the taxing statute be redrafted and rearranged to eliminate excess verbiage and to clarify the meaning.

4. That the statute clearly define both the personal property, upon which tax is imposed, as well as the holders thereof, subject to the tax, and that these concepts be kept clearly distinct.

5. That in case the recommendations in 2 above are followed, Section 16 of the personal property tax act be amended to permit the continuance of the present practice of corporations and municipalities, covenanting to bear and pay the tax upon their bond issues.

6. That the "principal value of annuities, yielding over $200.00 per year" be exempted from the tax.

7. That the personal property holdings of employes pension plans be exempted from the tax.

8. That personal property, held by a resident for a non-resident, be exempted from the tax, so long as the creator of the trust is a non-resident, or after his decease.

9. That the shares and the holdings of corporations, liable to *or relieved from* the capital stock-franchise taxes or liable to a tax on shares, *the gross premiums, the gross receipts, and the net earnings taxes* be exempted from the tax.

10. That the obligations, issued or assumed by first class and non-profit corporations, but held by taxable holders, be clearly subjected to the tax.

11. That the definition of taxable personal property be amplified to include all of the obligations of municipalities, municipal authorities, and other quasi-public organizations.

12. That the holdings of first class and non-profit corporations be expressly exempted from the personal property tax.

13. That a provision, imposing a tax similar to that, formerly imposed by the Act of 1897, and applicable to both state and federal building and loan and savings and loan associations, be added to the personal property tax act.

BIENNIAL TAX COLLECTIONS
LOANS TAX

Biennium	*Amount* (in thousands) *Normal*	*Emergency*[1]	*Total*	*Percent of Total Taxes*	*Average State Income* (in millions)
1923-1925	$12,667	......	$12,667	9.16	$6,149
1925-1927	12,796	......	12,796	8.00	6,356
1927-1929	12,991	......	12,991	6.95	6,587
1929-1931	15,521	......	15,521	6.40	6,775
1931-1933	14,094	......	14,094	6.43	4,773
1933-1935	16,325	......	16,325	8.35	4,216
1935-1937	17,259	$3,481	20,740	5.55	5,046
1937-1939	11,941	6,670	18,611	4.50	5,416
1939-1941	12,465	5,739	18,204	4.37	6,052
1941-1943	9,528	5,397	14,925	3.19	8,075
1943-1945[2]	9,100	5,947	15,047	3.26	10,076

[1] Corporate loans only.
[2] Actual and estimated.

A comparison of the receipts from the normal tax on corporate and municipal loans and the state's share of national income shows this tax to bear little relation to trends of state income, particularly since 1931. Since that date the yields have been very erratic, with peak collections of $17.3 million of normal taxes occurring in 1935-1937, when the state's average income was $5,046 million. It fell, however, to $9.5 million in 1941-1943, when the state's average income increased to $8,075 million.

This decline in revenues from the loans tax may be ascribed to the gradual reduction of indebtedness of corporations and municipalities, the lower volume of new, long-term financing, and the refinancing of corporate indebtedness, at such low rates of interest as to make corporate bonds unattractive for individual and trust investments. This last factor is clearly illustrated by a recent study by a large corporation of its own experience. This study disclosed that, of the corporation's 5½ percent bonds, 56 percent were held by individuals; of its 3½ percent bonds, 16 percent were held by individuals; and of its $2\frac{3}{4}$ percent bonds, only 5 percent were held by individuals.

The above study reveals that, as the interest yield decreased, the investment of individuals and trusts decreased. These low-yield bonds are absorbed largely, by banks, insurance companies, other corporations, and charitable foundations, in whose hands they are exempt from the Commonwealth's tax on corporate loans. It would appear that a reversal in the trend of long-term interest rates is necessary before this tax again shows an increase in revenue. In the last decade it has proved neither relatively stable nor responsive to economic changes.

CHAPTER 17

WRITS, WILLS, AND DEEDS TAX

The tax on writs, wills, and deeds, which is here treated as a capital tax, had its origin in 1830, when the prothonotaries of the Courts of Common Pleas and the prothonotary of the Supreme Court, having original jurisdiction, were required to demand and receive on every original writ, issued out of said courts, on the entry of every amicable action, on every writ of certiorari to remove the proceedings of a justice of the peace or alderman, and on every judgment by confession or otherwise, the sum of 50 cents, and, on every transcript of a judgment of a justice of the peace or alderman, the sum of 25 cents.[1]

The first section of the Act of 1830 also imposed a tax of $3.50 on every writ of error or appeal to the Supreme Court, but this tax was abolished in 1897.[2]

The Act of 1830 also imposed on every deed, mortgage, and other instrument in writing, offered for recording, a tax of 50 cents.[3] This tax is imposed on the oath and bond of an officer, when they are recorded, and, if they are in one paper only, one fee is charged.[4]

In 1832 this tax of 50 cents was imposed on the probate of any will and the granting of letters testamentary thereon and also on the granting of letters of administration.[5] Only one fee is charged for a will and letters testamentary thereon.[6]

The tax does not apply to sheriff's deeds, recorded in the prothonotaries' offices; it applies only where such deeds are recorded in the recorders' offices.[7] The tax is not collected on the recording of a certified copy of a will, probated in another county.[8]

A tax of $10 is also laid on the recording of commissions of certain officers, many of which have long since been abolished. Most, but not all, county officers are enumerated.[9] Eastman, in a footnote in his

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[1] April 6, 1830, P. L. 272, Sec. 3.
[2] May 19, 1897, P. L. 67, Sec. 3.
[3] Sec. 4 of the Act of 1830, *supra*.
[4] State Taxes, 16 D. R. 619.
[5] March 15, 1832, P. L. 135.
[6] State Taxes, 16 D. R. 619.
[7] State Taxes, 13 Pa. C. C. 473.
[8] State Taxes, 16 D. R. 619.
[9] April 6, 1830, P. L. 272.

"inspector of ground black oak bark, butter, and lard."

These state taxes are collected through monthly reports by county officers to the Department of Revenue, while the accounts of county officers are audited by the Auditor General.[10] A commission of 3 percent of the tax is allowed to the officer for paying over the tax.[11]

Under an Act of 1925 the fee for a marriage license is fixed at $2.50, of which 50 cents are for the use of the Commonwealth.[12]

This source of revenue produced $635,000 in the biennium, 1941-1943. Aside from moneys, collected through county treasuries for fish, game, and dog licenses, it is today the only state revenue, locally collected. The expense of auditing the accounts of prothonotaries, recorders of deeds, and clerks of the Orphans' Courts in the 67 counties of the state and of keeping accounts in the Departments of Revenue, Auditor General, and State Treasury must be considerable.

The change of this tax from a state to a county tax would be a logical step and would avoid the considerable auditing and administrative expense involved. The tax is a proper one for the county, which provides the offices and services for the recording and keeping of the records of the taxed actions and documents.

Recommendations:

1. That the tax on writs, wills, and deeds and the fee on marriage licenses be changed from a state tax and fee to a county tax and a county fee, respectively.

2. That a survey be made to ascertain whether other transactions in counties should be subjected to the tax.

BIENNIAL TAX COLLECTIONS
WRITS, WILLS, AND DEEDS TAX

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Biennium*	*Amount* (in thousands)	*Percent of Total Taxes*
1923-1925	$933	0.67	1933-1935	$572	0.29
1925-1927	953	0.60	1935-1937	585	0.16
1927-1929	918	0.49	1937-1939	575	0.14
1929-1931	789	0.33	1939-1941	608	0.15
1931-1933	657	0.30	1941-1943	635	0.14
			1943-1945[1] ...	604	0.13

[1] Actual and estimated.

[10] Fiscal Code, April 9, 1929, P. L. 343, Secs. 901, 902.
[11] April 6, 1830, P. L. 272, Sec. 7.
[12] May 2, 1925, P. L. 494.

CHAPTER 18

STOCK TRANSFER TAX

Stock transfers were first made subject to tax in 1915.[1] The tax is imposed upon sales, agreements to sell, deliveries, or transfers of shares, or certificates of stock of all domestic and foreign associations and corporations, except building and loan associations, at the rate of two cents on each hundred dollars of the face value or fraction thereof, except where such shares are issued without designated monetary value, in which case the tax is two cents for each share. Various kinds of transfers, however, have been exempted from the tax. Most of these relate to cases, in which the beneficial interest is not conveyed, although it cannot be said that the exemptions follow any such principle. On the contrary, over the years an effort has been made simply to conform the exemptions to those, contained in the federal stock transfer tax provisions. Since the Internal Revenue Code is revised almost every year, this effort has not been very successful. It has resulted in numerous amendments,[2] which naturally have not synchronized with the federal provisions.

In 1943[3] the act was amended to restrict the application of the tax, in the case of sales on exchanges, to sales in excess of one hundred shares or the unit of trading on the exchange in question. This amendment was not included in the subsequent 1943 amendment, referred to above, and there has been no judicial expression concerning its effect or constitutionality as lacking uniformity.[4]

The rates of the tax are manifestly inequitable. The tax is the same in amount, whether a share transferred has a par value of $100, $50, $10, or no par value at all; and there is, of course, no relation between the tax and the actual value transferred. The equities of a somewhat similar scheme of taxing spirituous liquor have been severely condemned by the courts.[5]

The tax is paid by the affixing of a stamp, obtained from designated agents of the state, to the share transferred, the agreement to transfer it, or in default of these, to the entry in the books of the cor-

[1] Act of June 4, 1915, P. L. 828.
[2] Acts of May 8, 1919, P. L. 120; May 4, 1933, P. L. 278; June 15, 1939, P. L. 403; and May 27, 1943, P. L. 680.
[3] Act of May 7, 1943, P. L. 242.
[4] Under Article IX, Sec. 1, of the Constitution.
[5] Commonwealth v. A. Overholt & Co., 331 Pa. 182.

poration, by which the transaction is recorded. In the case of small companies, whose stock is not traded on exchanges and whose officers are unfamiliar with the provisions of the act, the problems of proper enforcement can well be imagined.

To facilitate enforcement, the act requires all corporations to maintain transfer records in the state. This obviously can only apply to Pennsylvania corporations, although it is not so stated. Theoretically, the tax is imposed upon transfers of stock of foreign corporations, but it is simply not collected in most of such cases, and there is no conceivable way in which collection can be enforced, where the transfer is made directly or handled through a non-resident broker.

Actually, in view of these defects, together with the relatively low yield of the tax, the expense of attempting rigid enforcement cannot be justified.

To a slight degree, the tax is prejudicial to Pennsylvania and favorable to foreign corporations. It is doubtful whether it is actually a factor in inhibiting Pennsylvania incorporations and the business of Pennsylvania exchanges, although in theory it has that tendency.

It is, however, a nuisance tax, impeding and complicating, although not directly burdening, corporate activities in the state. The tax results in considerable expense and irritation to transfer agents, brokers, and banking institutions, upon whom the burdens of collection and accounting principally fall. As it is framed and administered, it is lacking in uniformity, inefficient, and, hence, an objectionable levy. Its elimination from the state's tax system would involve a reduction in revenue of only about $600,000 a biennium.

In the case of small corporations, which have infrequent stock transfers, the tax is probably not paid in many instances, due to a lack of knowledge of the existence of the law. In such cases, those making the stock transfer are liable to criminal prosecution under Section 6 of the tax act, and, under Section 17 of the act, no transfer, on which the tax has not been paid, can be made the basis of a legal act and no proof of the transfer can be offered in evidence.

This tax is found only in New York, Pennsylvania, Massachusetts, South Carolina, Texas, and Florida. Its elimination would bring Pennsylvania in line with the great majority of the states.

Recommendation:

That the stock transfer tax be repealed.

BIENNIAL TAX COLLECTIONS
STOCK TRANSFER TAX

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Biennium*	*Amount* (in thousands)	*Percent of Total Taxes*
1923-1925	$475	0.34	1933-1935	$580	0.30
1925-1927	592	0.37	1935-1937	1,039	0.28
1927-1929	1,076	0.58	1937-1939	669	0.16
1929-1931	1,221	0.50	1939-1941	661	0.16
1931-1933	692	0.32	1941-1943	593	0.13
			1943-1945[1] ...	1,070	0.23

[1] Actual and estimated.

CHAPTER 19

TAX ON BOXING AND WRESTLING GROSS RECEIPTS

A tax upon the gross receipts of boxing and wrestling exhibitions was first imposed in 1923[1] by the act, which created the State Athletic Commission and legalized boxing and wrestling. The tax is at the rate of five percent of such gross receipts, exclusive of any federal taxes, and is payable within seventy-two hours of the exhibition. Matches, conducted by educational institutions, in which the participants are students, are exempt.

This tax, which may be classified as a "consumption" tax, has produced revenue almost sufficient to pay the costs of state regulation.[2] It should be retained for this purpose alone and the policy should be established that the appropriations for administration should not exceed the revenues from this tax, even if the rate of the tax must be increased.

Recommendation:

That the tax on gross receipts from boxing and wrestling be retained to pay the cost of state regulation.

BIENNIAL TAX COLLECTIONS
BOXING AND WRESTLING GROSS RECEIPTS TAX

Biennium	*Amount* (in thousands)	*Percent of Total Taxes*	*Biennium*	*Amount* (in thousands)	*Percent of Total Taxes*
1923-1925	$82	0.06	1933-1935	$64	0.03
1925-1927	208	0.13	1935-1937	80	0.02
1927-1929	166	0.09	1937-1939	81	0.02
1929-1931	172	0.07	1939-1941	82	0.02
1931-1933	94	0.04	1941-1943	88	0.02
			1943-1945[1] ...	85	0.02

[1] Actual and estimated.

[1] Act of June 14, 1923, P. L. 710, Sec. 23, as last amended by the Act of June 5, 1937, P. L. 1698.

[2] 1943-1945 revenue (actual and estimated), $85,000; appropriation for administration, $90,000.

CHAPTER 20

RECOMMENDATIONS WITH RESPECT TO NEW SOURCES OF TAX REVENUE

General Discussion

When the finances of the state and its political subdivisions are generally in excellent condition, the only possible reasons for the revision of the tax structure are to eliminate inequities, to relieve excessive burdens, to place the tax system on a sounder and more scientific basis, and to assist in advancing and maintaining the prosperity of the citizens of the state. The aim should be to assist in preserving after the war a vigorous private enterprise, upon which employment and prosperity will depend.

Both individuals and enterprises should contribute in fair proportion to the costs of governmental services because of the protection and benefits, derived therefrom. A tax system should be devised to accomplish that purpose. It is admitted by students of taxation that in the final analysis all taxes, necessary to pay the public expenditures of the several levels of government, must ultimately be borne by the individual, whether such taxes be direct or reflected in the cost of commodities or services which they buy. There is no escape from this conclusion.

Taxes, levied on capital, have a harmful effect and should be held to the minimum, necessary to provide a stable foundation for the tax structure. Any taxes, levied directly upon business concerns, are likely to restrain business activity more than taxes, imposed directly upon individuals. In any sound tax system a large proportion of public revenue should be derived from individual income and earnings.

Relief from local real estate taxes is apparent, where revenues are provided by the state in the form of subsidies. In townships of the second class, where the state has made generous grants-in-aid for road purposes, only 47 percent of the total township expenditures are derived from real estate and occupation taxes. In some townships, where special services, such as lighting, water, and sewage are not provided, the tax on real estate is negligible. However, in cities, the real estate tax for city purposes ranges as high as (in the City of Scranton) 87 percent of total revenues. This city, as well as other cities, boroughs, and townships of the first class, receive no grants-in-aid for road purposes.

From the early history of the Commonwealth to the present date the revenues of local government have been derived, in the main, from taxes on real estate. Aside from the personal property tax, collected for county purposes, no successful effort has been made to provide other general revenues to aid in financing local government, except through state subsidies and through a special law, now applicable only to Philadelphia. In addition, local expenditures have been relieved through the assumption by the state of certain local functions and through the absorption of a large mileage of local roads into the state highway system. These approaches to the problem have increased the state budget enormously and, as a result, the state budget neither accurately reflects the cost of operating the state government nor the costs of the particular functions, allocated by law to the state.

Grants of subsidies from a central government to its subdivisions reduces local control of expenditures, discourages thrift, and is generally improvident and unwise. When, however, the central government is better equipped to collect a tax and acts only as the agent for its subdivisions, when local control over expenditures is maintained, and when the individual taxpayer is made fully aware of his direct contribution to local expenditures, the dangers inherent in such allocations are minimized.

In the future the state should discontinue all subsidies to political subdivisions in the interest of more economical administration. In lieu of subsidies, it should dedicate particular revenues to political subdivisions but, where a tax is so dedicated, it should be state-collected, where the state is better equipped to perform this function in respect to the particular tax. The tax, nevertheless, should be levied for local and not for state purposes. The aim should be complete separation of state and local functions and state and local revenues.

In 1942 the revenues of all political subdivisions were $448,724,000 including state and federal subsidies, passing through the State Treasury, of which $303,158,000 came from real estate and in the form of per capita, occupation, and poll taxes. The three last named taxes produced negligible amounts. It is quite apparent that a material reduction in this annual real estate tax burden can only be effected by the addition to the tax system of some broadly based tax, which would also serve the purpose of reducing expenditures from state funds in the form of subsidies and, at the same time, result in a reduction of the total taxes, collected for the state.

In considering a broadly based tax, the purpose is not to provide more public revenue, but to enable the state and political subdivisions to reduce other taxes, the burden of which are unjust and inequitable, and to eliminate from the tax structure those taxes, which are today wholly out of line with good tax practice.

If it may be contended, as some experts do, that the federal "tax base must be broadened by reaching more of the national income, which is now virtually untaxed," [1] how much more is such a contention applicable to a state, which presently has neither an individual income tax, a general sales tax, or any other broadly based tax, applicable generally to individuals.

Broadly based taxes are quite common in other states. Thirty-three states levy taxes on individual net income, but in three of these states the tax is restricted to income from intangibles only. The latest information on sales taxes shows that twenty-four states have taxes on general sales, use, or gross receipts and in several states, having no general sales taxes, such taxes are authorized to be collected by cities. In two other states the sales tax is imposed only on unincorporated business. Thirty-eight of the forty-eight states have either individual net income or general sales taxes and of these states, seventeen have both forms of taxation.

The Pennsylvania mercantile license tax, repealed in 1943, was in its nature a sales tax, although levied on gross receipts, as is also the case of taxes on unincorporated business, now levied in the states of Connecticut and Rhode Island.

These two forms of broadly based taxes on sales and income are therefore quite common in the United States. The incorporation of some broadly based tax into the state tax system would constitute no departure from the general trend throughout the United States. In fact, Pennsylvania has lagged behind the other states in this respect.

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[1] Twin Cities Postwar Federal Tax Plan.

Tax on Retail Sales

It has been noted, heretofore, that twenty-four states impose a tax on retail sales and of these, sixteen impose a use tax. In New York, where no state sales tax is imposed, the City of New York imposes a sales tax, a gross receipts tax, and compensating use taxes. The City of New Orleans imposes a sales tax in addition to that imposed by the State of Louisiana. Denver, Jefferson City, Kansas City, and St. Louis impose sales taxes on cigarettes.

Prior to 1929, general sales taxes were virtually unknown in this country. Since that time this tax has become an important device for obtaining revenue in many states. While in some states sales taxes originally had future termination dates, it is significant to note that many states have elected to renew statutes about to expire without specifying future termination dates. Originally, an emergency tax, designed to meet a crisis, caused by falling revenues, this form of tax shows every evidence that it will become a permanent addition to the tax structure in many states. Today its retention or its enactment is urged in the main for the relief of property taxation. State expenditures for schools, old age assistance, and public assistance have been the most prominent reasons for tapping this new source of revenue. These reasons find expression in various enactments. In North Dakota the law is entitled "An act to equalize taxation and replace in part the tax on property." In New Mexico the purpose is stated as one "to meet the emergency in regard to public schools of the state and to provide funds for the proper maintenance and support of public schools." In Colorado the funds were used for indigent unemployed residents; in Ohio, for relief purposes. Other illustrations might be noted.

A tax on retail sales is paid directly by the consumer out of income and earnings; it is not levied on capital, property, or production. The taxpayer at the time of the purchase is made fully conscious of the tax, which he pays in addition to the cost of the commodity.

A sales tax insures a direct and widespread participation in the support of government, not possible under any other form of taxation. It is a tax on spendings and not on savings. One great advantage is that the revenues from a sales tax are current.

In Pennsylvania, where, because of constitutional limitations, an individual income tax of the type, prevalent in other states, is not feasible, even if the federal government had not already practically pre-empted this field, the sales tax offers the most acceptable possibility among the few broadly based taxes at all suitable to the Commonwealth. This tax has been demonstrated as successful in many states. The administration of the tax is reasonably simple and economical, since the collecting agency deals only with retail outlets and not individual returns.

It is evident from its present widespread use that the political unpopularity of the sales tax is highly exaggerated. In those states, where the sales tax is in effect, it has been accepted after the usual political debate and there has been little concerted agitation for its repeal. In a Gallup poll of November, 1943, it was shown that 53 percent of the voters of the country preferred a federal sales tax over an increase in personal income taxes, as against only 24 percent who favored increased income taxes.

An advantage of the sales tax is that the taxpayer can, to a limited extent, protect himself against the tax by curtailing his spending, particularly in the field of luxury purchases.

The principal objections to the sales tax are (a) that it violates the "ability to pay" principle, (b) that it curtails mass purchasing power and is, therefore, deflationary in its effect, and (c) that it results in a loss of sales to neighboring states through mail order houses and otherwise.

The "ability to pay" principle, recognized chiefly in the individual net income tax, has been carried to the absurd extreme, where the double levy of the federal and state governments have almost consumed all of the net income of individuals in the higher brackets. The federal government has been forced to a continual lowering of its exemptions in order to reach more of the national income. The individual exemption has been reduced to $500 and the minimum tax rate on the excess is 3 percent or $3 a hundred, and the surtax rates range as high as 91 percent on incomes over $200,000. Federal Treasury estimates of income taxes, paid by groups, in 1943 were as follows:

	Income		
Taxpayers	*Over*	*Under*	*Tax Paid*
37,253,000	.....	$3,000	$4,288,000,000
5,221,000	$3,000	5,000	2,117,000,000
1,495,000	5,000	25,000	2,618,000,000
87,000	25,000	100,000	1,710,000,000
8,270	100,000	.....	1,256,000,000

Commenting on these figures, *Barron's National Business and Financial Weekly,* in the February 14, 1944 issue, calls attention to the fact that, as individual incomes rise, the number of taxpayers in a class, and to a lesser but appreciable degree, the tax revenue to be derived from that class decreases. "It is obvious where the money lies. It is obvious where it must come from, if it is to reach the government coffers at all—from the small-income groups!"

There is no direct evidence that a sales tax at a reasonable rate curtails mass purchasing power. It may have a slight effect in the luxury field, but it should not have that effect, where commensurate reductions in tax burdens are given to at least a large part of our population, which is now called upon to pay direct poll, occupation, and school per capita taxes in lump sums, which in some cases are commensurate with taxes on retail sales at a reasonable rate.

In 1936 the per capita impact of a 2 percent tax on retail sales in certain states was estimated as follows:

Colorado	$6.02
Wyoming	6.60
Utah	5.86
Iowa	5.45

In the same year the per capita impact in states having a 3 percent rate was as follows:

Illinois	$9.28
Michigan	9.62

There is no concrete evidence of the contention that a sales tax results in any appreciable loss of sales to neighboring states. New York City has such a tax. Yet there are nearby important shopping centers across the Hudson River in New Jersey, which does not have the tax. Ohio has had a sales tax for some years, while Pennsylvania and Kentucky, neighboring states, did not have the tax. Illinois, which has the tax, is bordered on the south by Kentucky and on the north by Wisconsin, neither of which have the tax. North Carolina is surrounded by three states, Virginia, Tennessee, and South Carolina, none of which have a sales tax. Other illustrations could be given.

There can be little question that the Pennsylvania tax system is in need of a broadly based tax to arrive at a sound, well balanced, and equitable distribution of the tax burden in the Commonwealth. The tax on retail sales is the outstanding one, which best meets the test of reaching the wages and incomes within the Commonwealth, which are now virtually free of state and local taxes. Coupled, as it would be, with the federal income tax, those with the ability to pay are now, and after the war will be, called upon to continue their commensurate contributions to the federal government. Moreover, the federal government in the future is likely to revive heavier individual exemptions, thus directly favoring the small income groups. Furthermore, the federal government has no general sales tax and appears unlikely to invade this field after the war. Duplicate taxation, except in limited fields, such as tobacco, liquor, and liquid fuels taxes, is consequently avoided.

In 1932 Pennsylvania adopted a temporary sales tax, which imposed a 1 percent rate on each dollar of the gross receipts, derived from sales of tangible personal property. The tax was in effect for only six months and, as intended, realized the sum of $10,000,000. The tax was levied in addition to the mercantile license tax, since repealed. This sales tax was in reality imposed on the vendor and was not a "pass on" tax, but vendors were authorized to add the tax to the retail sales price, if display signs, tickets, tags, and bills, rendered in connection with sales, stated the commodity price separately from the tax. However, the tax was essentially a gross receipts tax and much of it was absorbed by the vendor.

A tax on retail sales would afford the means of raising a large revenue for the support of the common school system. Such a tax, together with other state taxes, which in this report are recommended for dedication in support of public education and other local functions, would:

(a) Grant substantial relief from the presently heavy burden of real estate taxes, imposed for school purposes;

(b) Permit the abolishment of the per capita tax, which in many school districts now runs as high as $5 per adult individual and is an inefficient tax;

(c) Enable the state to discontinue appropriations from its General Fund for school purposes and thus effect material readjustment in the present tax structure of the state.

Retail sales taxes are of various types. Some of them are pure gross receipts taxes. Others, like that in Ohio, which has a 3 percent tax, impose a one cent tax, where the price is 40 cents or less; 2 cents, where the price is 70 cents or less, but more than 40 cents; and 3 cents, where the tax is more than 70 cents and not more than $1.00. On each subsequent $1 the graduation is the same. Purchases of less than 9 cents are not taxed, and the first 8 cents of every dollar after the first pays no additional tax. Whether Pennsylvania can adopt such a system under the judicial interpretation of the uniformity clause of its Constitution may be open to question.

However, there can be no constitutional question, where the retailer is made liable for the collection and payment over of the tax, provided the tax is passed on to the consumer. In the case of Wilson v. City of Philadelphia (330 Pa. 350), the State Supreme Court passed on a temporary Philadelphia sales tax ordinance, which provided that, in computing the tax, fractions of less than 1/4 of a cent should be disregarded and fractions of one-fourth or more of a cent should be computed as one cent. The ordinance was held not to offend the requirement of uniformity of the state constitution. Complete equality of taxation could have been secured only by the coinage of tax tokens or the issuance of stamps. Such a solution, said the court, would be both oppressive and unnecessary. A state tax statute, framed on the theory of the Philadelphia ordinance, in reality would grant an exemption of small sales from the tax, since it would recognize that coins in denominations of less than one cent are not available for the payment of the tax.

Under a tax of 2½ percent on retail sales, modeled on the Philadelphia plan, a tax would be collected only, when a sale amounted to 10 cents or more. The following table indicates how such a tax would operate:

Value of Purchase	*Tax*
9 cents or less	No tax
10 cents to 49 cents	1 cent
50 cents to 89 cents	2 cent
90 cents to 109 cents	3 cent
110 cents to 149 cents	4 cent
150 cents to 189 cents	5 cent

Recommendation:

(1) That a state sales and use tax be adopted at a 2½ percent rate, applicable to sales, not for resale, of tangible personal property:

(2) That the retail sales and use tax shall not apply to property, now subject to selective sales taxes, such as cigarettes, liquid fuels, and malt, vinous and spirituous liquors, nor to services, such as gas, water, electric, communications, transportation, radio, newspapers and magazines, personal services, and amusement admissions, sales to the United States, the State of Pennsylvania and its political subdivisions, sales by farmers of products of their own production, and sales of tangible personal property for mining and manufacturing purposes, or to casual sales;

(3) That the tax be specifically dedicated for school purposes, but collected by and through the State Department of Revenue;

(4) That a reasonable commission be paid to the retail dealer for collection of the tax;

(5) That the cost of state collection be absorbed by the Commonwealth and no deduction made from the proceeds of the tax to reimburse the state.

It is estimated that such a sales and use tax at the rate of 2½ percent will yield $152,000,000 in a biennium, based on the 1943 volume of retail sales, as estimated.

A Tax on Unincorporated Business

With the repeal of the mercantile license tax in 1943, unincorporated business became completely freed from all taxation for state purposes. There were excellent reasons for the repeal of this tax. Its administration was cumbersome and costly, the burden of the tax was unequal, because of the variation in margin of profit among dealers, and, since the tax was also imposed on incorporated business, which already paid taxes on capital stock and corporate net income, it did not aid, as intended, in any manner in removing competitive disadvantages. It was one additional link in the chain, which tended to induce certain types of corporations to dissolve their corporate entities and return to individual or partnership ownership and operation.

In the mercantile field and, perhaps, to a smaller degree in other fields, unincorporated business is in direct competition with incorporated business, which is forced to pay capital stock and corporate net income taxes to the Commonwealth.

This competitive disadvantage to corporations is removed to an extent in some other states by specific taxes on unincorporated business. The State of New York levies a net income tax on any unincorporated business, wholly or partly carried on in the state. The rate of the tax is 4 percent. In addition to customary deductions, $5,000 for each member of a partnership, or a percentage of gross income, is also deductible from gross income, as representing the earnings of the proprietor.

Such a provision is probably unconstitutional under the construction of the uniformity clause of Pennsylvania.

The State of Connecticut imposes a gross receipts tax on unincorporated business, the rates of which vary from 25 cents to $1 per thousand dollars, with a minimum tax of $5. The businesses taxed are enumerated and comprise generally the retail trades and manufacturing. However, the tax is also imposed on motor transportation.

A gross receipts tax for this purpose is not deemed proper for imposition in Pennsylvania, because it is inequitable to certain lines of business, in view of the small margins of profit and the frequency of inventory turnover in the state. It also closely follows the mercantile license tax, repealed because of its various defects.

A net income tax on unincorporated businesses, however, is wholly feasible and, it is believed, can be constitutionally enacted in Pennsylvania at a flat rate, if no exemption from the tax is granted. If corporations, engaged in business, can be classified for the imposition of a corporate net income tax, as has been done with judicial sanction, it seems to follow that individuals, engaged in business, may be similarly classified and taxed, particularly, since the tax results in more nearly equalizing the tax burden between the two classes of business enterprise. This was indicated in Fox's Appeal, 112 Pa. 337. In any event, the tax is, in reality, levied on the privilege of engaging in business, although measured by net income; it is a tax on business and not on individual income.

In the enactment of such a tax, it may first appear that no deduction should be allowed for the salary or compensation of the proprietor, because in many cases his salary could be fixed sufficiently high to absorb all the profits of the business. However, the salary or compensation of the proprietor represents to him the same income as the earnings of other individuals, who work in other lines of endeavor. In one case a salary would be taxed and in the other case, not taxed. It has been suggested that this inequality might be overcome by reducing the rate of the tax, as compared to the corporate net income tax. However, the difficulty is that a tax would still be imposed on the actual salary of a proprietor, whose business produced in profits no more than he was reasonably entitled to receive for the work, performed in conducting the business.

Under the circumstances, it would appear wise in the framing of such a law to assure that the salary or compensation of the proprietor be allowed as an operating expense. In order to avoid abuse, the Department of Revenue should be vested with full discretion to disallow any salary deduction over and above a reasonable sum, commensurate with the services rendered and the amount of business done. Admittedly, this may cause some administrative difficulties, but this is apparently inherent in such a tax in Pennsylvania. Such a provision would probably be upheld as constitutional.

It is not pertinent here to define the businesses, which should be included under such a law. The experience of other states should be followed.

From such a tax should be exempted all farmers, who sell their own products, professional men, who derive their income solely from their individual efforts, and such persons as agents, salesmen, and brokers, not engaged in the sale of tangible commodities.

It is estimated that a four percent tax on unincorporated business would yield $25,000,000 in a biennium.

Recommendations:

1. That a state net income tax be imposed on unincorporated business at a rate equal to the rate, imposed on incorporated business under the Corporate Net Income Tax Act, and that the revenues from this tax be used first for county purposes, so as to enable counties to bear part of the cost of public assistance, and the amount, not needed for this purpose, be allocated to municipalities.

2. That the State Constitution be amended to permit uniform basic exemptions for income, inheritance, estate, and excise taxes.

The Pennsylvania Turnpike

The act, providing for the construction of the Pennsylvania Turnpike from Middlesex in Cumberland County to Irwin in Westmoreland County, and the two acts, providing for the extension thereof to West Virginia or Ohio in the West and Philadelphia in the East, declare that, when the bonds, issued to pay for these projects, have been retired, the Turnpike shall become a part of the system of state highways and shall be maintained by the state, free of all tolls.

This turnpike is a luxury highway, which has been constructed to afford a means of safe and speedy transportation and, by reason of its easy grades and other engineering features, is less expensive than the ordinary highway to the motorist from an operating viewpoint, particularly, in the case of commercial trucks and busses.

If this highway is extended across the state in accordance with existing laws or the plans of the Pennsylvania Turnpike Commission, which contemplate a "Y" in the West to the state of West Virginia and Ohio and, in the East, a "Y" to Philadelphia and to the Delaware River in the direction of New York, it follows that a large interstate truck and passenger traffic will use this highway, and that the Commonwealth will receive little benefit therefrom, since major centers of population will be by-passed. Tourist travel to points of interest, which the state is trying to foster, will be discouraged and directly impaired.

The Commonwealth is entitled to revenues from this travel, after the cost of this highway has been amortized. Tolls provide a method to secure revenues from non-residents without the erection of interstate barriers to the free flow of traffic. No one is obliged to use the Turnpike; those doing so consent to pay for this privilege.

In the early years of the Commonwealth private capital was employed to construct principal arteries of travel, and toll roads were common in this state. This situation was found unduly restrictive and developed the concept that all toll roads should be free for public travel. However, this concept was applied to roads, which afforded the most direct arteries and, in some cases, the only arteries of travel between two points. These roads were necessities, not luxuries.

Many persons, interested in the development of our modern system of highways, are opposed to the construction of such luxury roads and contend that experience has demonstrated that they cannot be made fully self supporting and can only be constructed through the aid of public grants. They contend that special taxes and license fees, imposed on motor transportation, are sufficient to build and maintain a main system of highways, free of tolls. Pennsylvania has provided this luxury highway and, it is assumed, the extension will be constructed, if public grants to aid in financing become available. There is nothing in the original set-up of this project, other than the statute, which requires that the present road, when paid for, be freed from tolls, except for military purposes. This entire cost should not be imposed on the motorists of this state, many of whom never use this luxury highway.

Recommendation:

That the existing Turnpike laws be amended to provide that, after all outstanding bonds have been amortized, reasonable tolls shall be permanently collected for the use of the Turnpike, sufficient only to pay for operation and maintenance and to provide a reserve for replacement purposes, and that military use of the highway be excepted from tolls.

CHAPTER 21

RECOMMENDATIONS WITH RESPECT TO STATE TAX ADMINISTRATION AND THE TAX CALENDAR

The following recommendations are made by the Tax Advisory Committee respecting the administration of state taxes. Most of these recommendations require amendment either to The Fiscal Code (Act of April 9, 1929, P. L. 343) or to some specific taxing statute, and in each case the statutory provision in question is indicated. Some recommendations can be accomplished by changes in administrative practice. None of the recommendations contemplates substantive changes in the imposition, decrease, or increase of a tax, as changes of this nature have been discussed elsewhere in this report.

RECOMMENDATIONS REQUIRING LEGISLATION

1. In the event that a tax settlement is not made within one year after a report is filed, no interest should be charged on the amount of tax unpaid from the expiration of such year until 60 days after settlement. (Amend Section 806, Fiscal Code.)

> Under existing law (Act of May 7, 1943, P. L. 229) there is a two year limitation. This can be shortened without undue burden on the fiscal departments of the state and thus further minimize the discrimination between a taxpayer, whose report is settled promptly and one, whose report, purely as a matter of chance, is not examined until some subsequent date.

2. Where the amount due under the corporate net income tax is increased as a result of a resettlement based on a Report of Change, interest on such increase should only be charged from 30 days after the date, upon which the Report of Change was required to be made. (Amend Sections 4c and 7, Corporate Net Income Tax Act.)

> In filing its original report, it is unfair to expect the corporate taxpayer at its peril to anticipate a change in its net income or tax resulting from federal exemption. This has been judicially decided in Commonwealth v. Bell Telephone Co. (55 Dau. 321), but this case is on appeal, indicating a possible ambiguity in the statute.

3. Where a taxing statute has been judicially held to be invalid or to have been erroneously construed, five years should be allowed

from the date of payment of tax or from *date of settlement* thereof, whichever is later, within which the taxpayer may petition for refund. (Amend Section 503 (4), Fiscal Code.)

> Under the self-assessing and concurrent payment feature of the law, most taxes are now paid before they are settled. This recommendation would give the taxpayer the full five year period to petition for refund under the circumstances stated in every case which was originally contemplated by The Fiscal Code.

4. (a) Interest at 4 percent should be paid by the state on the amounts of tax credits or refunds, resulting from resettlement upon petition for resettlement, review, or appeal or from a petition for refund, but not from original settlement. (Amend Sections 503, 1102, 1103, and 1105, Fiscal Code.)

(b) Interest on tax deficiencies should be reduced from six to four percent.

> It seems fair that the state should pay interest upon excess assessments of tax just as interest is exacted from the taxpayer upon delinquent payments. Of course, this provision should not apply to credits, resulting from original settlements, because to do so might encourage taxpayers to "invest" surplus funds with the state by means of over self-assessment of taxes.

5. More adequate appropriations should be made to pay refunds in cash. (Appropriation Acts of each Session.)

> Many taxpayers cannot readily use refunds in the form of credits, although this method of refunding taxes is most desirable from the state's standpoint. More liberal appropriations for cash refunds would alleviate the situation, although, as in the past, their use should be carefully restricted to meritorious cases.

6. The Attorney General's commission, paid upon delinquent accounts collected and in tax appeals, should be abolished. (Amend Section 1408, Fiscal Code.)

> This is an archaic survival of the days, when the Attorney General's office was financed solely on fees. It is not a substantial item of revenue. In tax appeals, where the commission is calculated on the amount in dispute, it is exceedingly difficult to compute.

7. The two taxing departments should be empowered to make settlements under Section 1105 of The Fiscal Code without securing permission from the Board of Finance and Revenue. (Amend Section 1105, Fiscal Code.)

> The departments know all the facts and securing permission from the Board, which is granted as a matter of course, is a useless and a time consuming formality.

8. Appeals in tax cases should be verified by, rather than required to be in the form of, an affidavit. (Amend Section 1104, Fiscal Code.)

> The present law required that the affidavit of the appeal contain the specification of objections. This awkward provision is not followed in actual practice and should be corrected.

9. When a petition for resettlement is refused, the petitioner should have the option of having the petition transferred to the Board of Finance and Revenue, there to be accepted, in conjunction with sworn notice, as a petition for review, with the right reserved to the petitioner to amend before date of hearing. (Amend Section 1103, Fiscal Code.)

> In most cases, when review is sought, following the refusal of a petition for resettlement, the petition for review is simply a repetition of the former petition. Some are very voluminous. This recommendation would save labor, material, and filing space.

10. If a resettlement is made on a Report of Change of Net Income, when a petition for review or appeal is pending, it should not be necessary to file a second petition for review or appeal. (Amend Sections 7 and 8, Corporate Net Income Tax Act.)

> The second petition or appeal is probably necessary under the present statutory provisions. Generally, it serves no useful purpose, because the contentions, raised therein, can readily be given effect in conjunction with the changed figures, supplied by the Report of Change.

11. The period, within which the Board of Finance and Revenue is required to dispose of a petition for review, should be extended to six months, but initial hearing thereon should be held within 90 days

of filing, unless waived by the petitioner. (Amend Section 1103, Fiscal Code.)

The present law requires the Board to dispose of petitions for review within 90 days of filing. If, as is usually the case, the hearing cannot be held until near the end of that period, and it develops that an investigation is desirable, no adequate investigation can be made. On the other hand, the present time limit is sufficient in those cases, where no investigation is needed.

12. The Board of Finance and Revenue should be eliminated and in lieu thereof an *independent* board of three full time members should be provided. This board would exercise the present functions of the Board of Finance and Revenue, having to do with state taxation and escheats. Other functions of the present Board should be vested in appropriate existing departments. (Amend Sections 201, 202, 405, and 1102, Administrative Code, and Sections 501, 505, and 506, Fiscal Code.)

The members of the Board, as presently constituted, simply review the work of their departments in many cases. Furthermore, the member from the Department of Justice is in the anomalous position of passing judgment on matters, in which he may later have to serve as an advocate. All members have other duties and cannot give the tax problems before the Board the time, which they deserve.

13. The self-assessment feature, presently provided with respect to certain state taxes, should be retained.

RECOMMENDATIONS REQUIRING CHANGES IN ADMINISTRATIVE PRACTICE

(1) (a) The present classification and salaries of the state's employes, making and supervising tax settlements and resettlements, should be revised to insure greater efficiency and more continuity.

(b) Civil service status should be given to employes of the Bureau of Corporation Taxes and the Receipts Accounting Section of the Department of Revenue and the Taxing Bureau of the Department of the Auditor General.

Good tax administration requires well-qualified personnel. While no criticism is intended of the present personnel, it has been greatly depleted by the entry of capable men into the armed services. Adequate salaries should be provided, not only to retain the present qualified employes, but also to attract and keep competent additions to personnel.

(2) Resettlement and refund certificates, issued by the Board of Finance and Revenue, should show complete and detailed tax computations, like settlements, now made by the taxing departments.

This recommendation is obviously desirable. The taxpayer is entitled to this information in any event and must have it, where an appeal is to be taken from the Board's action.

PROPOSED CHANGES IN TAX CALENDAR

Prior to the Act of February 2, 1937, P. L. 3, certain corporation taxes [1] were settled by the Department of Revenue, before the taxes were paid, and 60 days were allowed after settlement for payment of the tax, before interest began to run. Since reports for these taxes were filed as of March 15th of each year, taxes were not usually paid until after June 1, the beginning of the fiscal year. Tax moneys thus became available early in each fiscal year.

In the 1937 Act it was provided that taxes should thereafter be computed and paid by the taxpayer at the time of making the report. The result of this change was that these corporate taxes were paid before the close of a fiscal year instead of shortly after the commencement of that year and, consequently, in the single fiscal year, 1936-1937, two years' taxes were collected, which were used to balance the budget of the biennium. But this procedure necessitated the subsequent issue [2] of tax anticipation notes early in the fiscal year 1937-1938 and in the years which followed.

With an estimated surplus in the General Fund at the close of the present fiscal biennium, variously estimated up to $115 million, the opportunity is afforded the General Assembly to take decisive action to correct the situation, created by the Act of 1937, and to return to sound fiscal and budgetary practice. This can be accomplished by changing the date, when these tax reports and the corporate net income tax reports are to be filed, from March 15th and April 15th, respec-

[1] Capital stock-franchise tax, corporate and municipal loans' tax, and foreign bonus.

[2] Tax anticipation notes were first employed as a fiscal device in 1935 to aniticipate the revenues of the emergency taxes, imposed in that year.

tively, to June 15th, or in the case of corporations, reporting on a fiscal year basis, to $5\frac{1}{2}$ months after the commencement of the corporation's fiscal year, at the same time retaining the feature of the 1937 Act that taxes shall be paid concurrently with the filing of the tax report, subject, of course, to final adjustment after settlement by the Department of Revenue.

Such legislation could be adopted early in the session of 1945, so as to be applicable to reports made in the year 1945. It is estimated that such a change would transfer approximately $87 million of revenue from the 1943-1945 biennium to the 1945-1947 biennium. This would still leave an appreciable surplus at the end of the present fiscal biennium.

The receipt of major revenues, applicable to each fiscal year, at the beginning rather than at the end of that year, would eliminate the necessity of issuing tax anticipation notes at a cost to the Commonwealth of at least $3 million each biennium.

The readjustment of the tax calendar would permit the Governor, in approving the second six months' budget of each fiscal year, to have before him the greater part of tax collections for the fiscal year involved. Consequently, if tax collections were not up to budgetary estimates, adjustments of appropriated funds could be carried out with more certainty.

In preparing a budget under existing conditions, it is necessary to estimate three years' tax revenues in advance. In order to prepare a budget for the 1945-1947 biennium, revenues must be estimated for the period, extending from November 1, 1944 to May 31, 1947. Such a procedure requires projections of many of the major taxes, which under the present tax calendar will be collected for the calendar years 1944, 1945, and 1946. Such estimates, in periods of sharp fluctuations in national and state income, can result in fiscal estimates, wherein the Commonwealth may suffer extraordinary deficits, such as happened in the biennium 1933-1935, when the situation became so acute as to result in the emergency taxes, levied in 1935 and 1936.

The adoption of a constructive and equitable tax structure for the Commonwealth and its political subdivisions before the end of the current war, will permit the testing of the tax structure under the most favorable circumstances. The level of state income, which will necessarily prevail during the war, will insure sufficient revenues to provide a favorable testing period, following which the tax rates may be adjusted in case the estimates of yields should prove higher or lower than actual experience warrants.

Recommendation:

1. That the filing of corporate net income, franchise and capital stock tax reports be required not later than five and one-half months after the close of the fiscal or calendar year, and that the tax be paid concurrently therewith.

Miscellaneous Recommendations:

In conclusion, the Tax Advisory Committee recommends:

1. That the State Liquor Control Board adopt the policy of transferring to the Department of Revenue monthly, the liquor store profits, as well as the amount of taxes collected, making due allowances for adequate working capital.

2. That licenses intended for revenue be plainly labeled as revenue measures and that the amount, collected by this means, be proportionate to the actual needs of the taxing body.

3. That political subdivisions be prohibited from imposing licenses for inspection or regulation, when such licenses or inspection fees are imposed by the Commonwealth.

4. That all state licenses be issued permanently by the bureaus, presently authorized to issue them, and that they continue in effect until revoked for cause; and that the Department of Revenue issue all renewals automatically, unless notified by the licensing bureau that the license has been revoked or is in the process of being revoked; and that all licenses, where the fee is relatively small, be issued on a biennial rather than an annual basis.

5. That the license fees, now imposed on motor vehicles and operators, be continued at the present rate.

6. That certified public accountants be specifically authorized to appear and practice before the Board of Finance and Revenue or any body, which may succeed it.

A recent opinion of the Attorney General has raised serious doubts as to whether accountants may represent clients at all before the Board, although heretofore the practice was never seriously questioned. Many review petitions may properly and adequately be presented by certified accountants.

7. That there should be a statistical unit in the appropriate agency of the state govemnent to assemble, analyze, and correlate data on state revenue.

8. That a professional study be made of the bookkeeping system of the Department of Revenue.

[For the overall effect of the various recommendations of the Tax Advisory Committee, see Part I of this report under "Revenue and Other Effects of the Proposals of the Tax Advisory Committee."]

PART III

PROPOSALS FOR REALLOCATION OF CERTAIN GOVERNMENTAL FUNCTIONS AND THEIR COSTS AMONG THE COMMONWEALTH AND ITS POLITICAL SUBDIVISIONS

CHAPTER 1

BURDEN OF LOCAL TAXATION

The present allocation of governmental functions and financial responsibility therefor among the Commonwealth of Pennsylvania and its more than 5,200 political subdivisions is greatly in need of substantial reconstruction. The current division of responsibilites is the outgrowth of constant biennial changes, effected by action of the General Assembly from time to time, to meet emergency conditions or pressures, without a thorough, comprehensive analysis of the many and vital problems involved. The depression period, 1930-1940, which necessitated both state and federal grants to local units of government on an unprecedented scale,[1] greatly accentuated these problems and created much confusion as to the proper relations between the state and federal governments, on one hand, and the state and its political subdivisions, on the other hand. The result is that the present structure is inefficient, unscientific, and antiquated.

The present burden of taxation and debt, federal, state, and local, and the prospect of continued heavy tax burdens in the postwar years are in themselves sufficient to justify a most careful review of the relations between the state and its political subdivisions. Only by the utmost economy in operations and by efficiency in administration at all levels of government in the postwar years and by rigid adherence to constitutional jurisdictions of each level of government can there be any assurance that strong local governments will survive.

[1] For detailed analyses of federal and state subsidies in Pennsylvania in the past decade, see Report 10 of the Joint State Government Commission, entitled "The Economic Resources and Related Tax Problems of the Commonwealth of Pennsylvania," published January 3, 1945.

By transferring certain functions from the Commonwealth to its local units of government, the political subdivisions will be greatly strengthened thereby in their proper sphere of activity. By transferring other functions from local units to the Commonwealth, local revenue sources will be relieved of present undue burdens and the public will benefit through more efficient and uniform state-wide performance of these functions. In other cases, by the adoption of new taxes and reallocation of the revenues from other taxes, the tax base can be broadened and made more stable, more productive, and more equitable in its impact on taxpayers.

The distribution of tax sources among the state and its political subdivisions is at the discretion of the General Assembly. Local government taxation (with the exception of permissive taxes for Philadelphia alone) is restricted by state law to specific taxes upon classified subjects. The principal tax source of the Commonwealth's political subdivisions is the tax on real property, which is employed by all units of local government. There are, in addition to the tax on real property, taxes on intangible personal property, per capita, and occupation taxes, some minor special taxes, legislated before the adoption of the uniformity clause of the present Constitution, and, in Philadelphia, other special taxes, of which the wage tax is the principal one.

In 1942 local governments [1] of the Commonwealth collected 86.3 percent of their total tax receipts from real estate. Furthermore, the real estate tax furnished 75.8 percent of total local revenues and 65.1 percent of total local receipts, including state grants. In the same year, real estate contributed 38.1 percent of all revenues of the Commonwealth and its political subdivisions, including federal grants to the Commonwealth. Exclusive of federal grants, real estate contributed 41.2 percent of all state and local revenues in Pennsylvania.

From the available data, it appears that local taxation of property in Pennsylvania is heavier than the average of the forty-eight states. A study of comparative state and local property taxation in 1941, made by the U. S. Bureau of the Census, shows that Pennsylvania's local taxation of general and selected property provided, in that year 69.9

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[1] For a detailed discussion of the costs and revenues of local governments in the Commonwealth, see Report No. 1 of the Local Government Commission, entitled "Cost of Government in the Commonwealth of Pennsylvania," published September 1, 1944.

percent of the total revenue (including grants) of the Commonwealth's political subdivisions. This proportion was substantially greater than the average of 59.9 percent for the forty-eight states and the District of Columbia. In comparison with eight selected industrial states,[1] Pennsylvania's local tax burden on property was greater than any of these. In the eight comparative states the local tax burden on property, as a percentage of total revenue of local governments, ranged from 47.8 percent in Ohio to 68.4 percent in New Jersey, compared with Pennsylvania's 69.9 percent.[2] Realistically, moreover, experience in Pennsylvania has shown that almost exclusive reliance upon real property, as a tax source for local governments, has resulted in great hardship in the metropolitan or highly urbanized areas of the state, as well as in those sections of the state, commonly known as the "distressed" areas, in both of which areas the decline of assessed valuations has been most marked in the past decade. With the exception of piecemeal measures, including the state's assumption of the entire cost of public assistance in 1937, the General Assembly has given little recognition to the problem of local taxation, although more than 50 percent of the taxes of the Commonwealth and its political subdivisions are collected by local governments.

The most feasible means of providing permanent relief for real estate from the present inequitable burden of local taxation appear to be the following:

1. The extension of the taxing powers of local governments.
2. The provision of new revenues for local governments, either in the form of state-collected taxes, dedicated to local purposes, or of increased grants from the Commonwealth.
3. The transfer to the state from political subdivisions of the costs of and responsibility for certain functions, which they are now called upon by law to perform.

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[1] Massachusetts, New York, New Jersey, Ohio, Michigan, Illinois, Indiana and California.

[2] For further discussion of comparative property taxation, see Report No. 10 of the Joint State Government Commission, entitled "The Economic Resources and Related Tax Problems of the Commonwealth," published January 3, 1945.

Provision of New Revenues for Local Governments

New revenues for local government may be obtained either by the extension of their taxing powers or by allocation of certain state-collected taxes for local purposes. The broad extension of local taxing powers has the danger of seriously restricting, at some later date, the flexibility of a well-balanced state and local tax program. Furthermore, most of the major taxes, which have not been utilized either by the state or local governments in Pennsylvania, are of the type that could be more efficiently and economically administered and collected on the state level. For this reason the Tax Advisory Committee believes that broadly-based taxes, collected at the state level and distributed to local units of government on a reasonable and equitable basis, will furnish the greatest relief to local governments. A program, dedicating such taxes to specific local purposes, has the additional advantage of removing the constant pressures on the General Assembly for continuously increasing subsidies from the state's operating funds to local units of government, which result in both increasing the overall cost of the function and diminishing local initiative for sound and economical administration.

CHAPTER 2

SCHOOL DISTRICTS [1]

Although school districts perform only one function, namely, public education, in 1942 they collected 48.1 percent of all the real estate tax (including per capita,[2] occupation, and poll taxes, which cannot be segregated from real estate taxes, as reported), collected in the Commonwealth for that year. Real estate (and per capita taxes) constituted about 76 percent of the total revenues of the school districts in that year. The remaining 24 percent was received from state grants. The relationship of state grants to local revenues, however, varied for each class of school district—the more populous districts getting a lesser proportion of their income from state grants than the smaller districts as shown below:

Class of District	*Percent of State Grants to Total Revenue of School Districts 1941-1942*
First	8.2
Second	13.8
Third	22.4
Fourth	40.3
Average	23.7

State grants to school districts are on a reimbursement basis. The school districts disburse the amounts, required to carry on their operations and, upon application to the Department of Public Assistance, the state reimburses them for certain expenditures, based on at least ten different formulae.[3] For the 1943-1945 biennium the original appropriations for state reimbursements to school districts and for salaries and expenses of county superintendents, etc., amounted to

[1] For a complete analysis of the fiscal problems of the school districts, see Reports Number 2 to 7 of the Joint State Government Commission: Report No. 2, "Fiscal Operations and Debt of the School District of Philadelphia, 1920-1943", dated May 10, 1944; Report No. 3, "Fiscal Operations and Debt of the School District of Pittsburgh, 1919-1943", dated May 11, 1944; Report No. 4, "Fiscal Operations and Debt of the School District of Scranton, 1919-1943", dated May 12, 1944; Report No. 5, "Fiscal Operations and Debts of Eleven Selected School Districts, 1920-1943", dated June 19, 1944; Report No. 6, "An Analysis of the Fiscal Operations of the School Districts of the Commonwealth of Pennsylvania, 1920-1942", dated June 21, 1944; Report No. 7, "An Analysis of Public Expenditures for Education in the Commonwealth of Pennsylvania", dated June 21, 1944.

[2] It is estimated that per capita taxes in school districts in 1942 represented 6.8 percent of total school district taxes.

[3] For a complete description of the formulae and the method of distribution, see Report No. 7 of the Joint State Government Commission, entitled "An Analysis of Public Expenditures for Education in the Commonwealth of Pennsylvania," dated June 21, 1944.

$116.967 million, but will be increased by deficiency appropriations, totalling $2.742 million, to a total of $119.569 million for 1943-1945 state grants to public schools. Of the new total, $104.742 million, or 87.6 percent, was for the reimbursement of teachers' salaries, tuition payments, and subsidies for closed schools. To distribute this last mentioned amount, at least seven different basic formulae were used.

Under the original Edmonds Act of 1921, school districts were reimbursed by the state for certain percentages of teachers' minimum salaries. These percentages varied for the different classes of school districts, as follows: school districts of the first class, 25 percent; school districts of the 2nd and 3rd classes, 35 percent; school districts of the 4th class, 50 percent. In 1923 this act was amended to provide different percentages of reimbursement for districts, which have a "true valuation of real property per teacher" of less than $100 thousand. This amendment differs materially from the original Edmonds Act, inasmuch as the amendment established the relationship of the value of real property to the number of teachers, rather than the class of the district, as the basis for state aid.

In 1941 an even more radical departure from the Edmonds Act was made, whereby the minimum salaries of teachers in 4th class districts were raised and the entire cost of the increase was assumed by the state. The method for ascertaining the amount, that each school district is entitled to received under this amendment, is in many respects even more complicated than the formulae, prescribed under the two previous acts.

The 1943 Session of the General Assembly granted temporary "cost-of-living increases" to all teachers earning less than $3,500. These increases, effective for the school years, 1943-1944 and 1944-1945, ranged from $100 per year for teachers, earning between $3,000 and $3,499 per annum to $300 for teachers, earning between $1,000 and $1,099 per annum. Again the entire amount of the increase was borne by the Commonwealth. It is estimated that the cost of this item will exceed the original appropriation of $24.3 million by $2.4 million, making a total of $26.7 million.

In addition to the reimbursements under the basic formula, school districts also receive state grants for salaries of full-time teachers in special education and extension schools to the extent of 25 percent of the prescribed salaries for 1st class districts and 30 percent for all other districts.

In the case of school districts, which do not maintain their own high schools, the state reimburses the districts for high school tuition, paid for pupils, assigned to other school districts. The percentage of tuition, which the state reimburses, varies from 30 percent to 60 percent, depending on the "true valuation of real property per teacher."

In order to encourage further consolidation of schools, the state changed in 1921 the basis for reimbursing each such fourth class school district to a rate of $200 for every school, closed since 1911, or for those, which had been closed under the provisions of the previous act of 1901. This amount is payable yearly in perpetuity, at least until the act is repealed. In addition, fourth class districts, in computing the true valuation of real property per teacher, are allowed to add one teacher for each teacher in every school, closed since 1923.

In addition to the grants for teachers' salaries, tuition, and closed schools, reimbursements are also made by the state for salaries of vocational teachers in vocational schools and for transportation of pupils. These reimbursements are also made on a percentage basis, depending on the true valuation of real property per teacher. The appropriation for aid to financially handicapped school districts is not based on any fixed formula, but is distributed at the discretion of the State Department of Public Instruction.

Apart from the complicated administrative machinery, made necessary for the distribution of reimbursements, due to the involved formulae, the present system of distributing state aid to school districts lends itself to various abuses, the major one of which is the relationship of true valuation of real property to the number of teachers in each district. By relating the distribution of grants to the presumed wealth of the district, an attempt was made to take into consideration the ability of the school districts to support the minimum standards of education, prescribed by the state. This might have been achieved, had the basis for determining the ratio of assessed valuation of real estate to true valuation been uniform throughout the state or even within individual counties. However, by arbitrarily increasing the ratio of assessment to true valuation, many districts are able to claim and receive higher percentages of state reimbursement than was intended under the legislative formula. Though the State Council of Education has authority to disallow the estimates, which result from this ratio, in effect the exercise of that authority is not practical, unless the State Council of Education constitutes itself as a state board of assessment in order to establish uniform realty assessments throughout the state. Because of this loophole, it is possible for certain districts to assert a greater ratio of assessed valuation to true valuation than is actually in effect, thereby decreasing the true valuation per teacher and assuring a higher percentage of state grants. In some instances it is also possible, by the arbitrary and fictitious addition of one extra teacher to the number actually employed, to decrease the true valuation per teacher and so qualify for a larger share of state grants. Such arrangements are particularly profitable in districts, where state reimbursement for teachers' salaries may amount to as much as 86 percent of the mandated teachers' salaries.

In addition to the undesirable conditions, brought about by the current method for distributing state aid to school districts at the present time, the system lends itself to a weakening of local responsibility and local control of expenditures and, thereby, discourages governmental thrift. Furthermore, it results in constant pressure on the Legislature, demanding greater grants from the state's General Fund. On the other hand, were the state better equipped to collect certain taxes and turn them over to local units on some reasonable basis, local control over expenditures could be maintained and thrift encouraged. This is especially true, when the individual taxpayer is made fully conscious, by the nature of the tax, of his direct contribution to expenditures for specific purposes.

Dedication of Taxes to School Districts

It is, therefore, proposed that the state program for assistance to school districts by grants from the General Fund be changed to a system, whereby the state would collect certain taxes and dedicate the revenues, received from such taxes, to school purposes. The yields of these taxes could be distributed to the school districts on the basis of a guaranteed amount of $1,600 per year for each teaching unit in each district in lieu of all present appropriations from the General Fund to school districts. Reimbursement for transportation of pupils should be continued in the case of fourth class school districts only, and should be made from these specially dedicated taxes.

In order to give full recognition to the size of the district, the size of teaching units should be established by the General Assembly in the various classes of districts, as follows: in first class districts, a teaching unit would consist of 33 pupils per teacher in average daily attendance; 2nd and 3rd classes, 30 pupils per teacher; and 4th class, 25 pupils. In the case of 4th class school districts where, because of the small number of pupils, it is impossible to maintain the 25 pupil-teacher ratio, the State Council of Education should be given the authority to grant the $1,600 on the basis of a smaller pupil-teacher ratio, depending on local conditions.

The amount that the state would be required by law to guarantee to school districts under the above formula would be $84,374,089 per year, as compared with actual payments during 1943-1944 of $57,391,696, an annual revenue increase of $26,982,393, or 47 percent, to the school districts.

The comparison of the effect of proposed distribution of state payments with actual state grants for the fiscal year, 1943-1944, by classes of districts, is shown below:

	Class of School District			
	First	*Second and Third*	*Fourth*	*Total*
Proposed Distribution on Basis of $1600 per Teaching Unit (including Transportation for 4th class districts only)	$12,996,800	$34,281,600	$37,095,689	$84,374,089
State Payments—fiscal year 1943-1944 [1]	5,102,506	20,832,955	31,456,235	57,391,696
Increase in School Districts Revenues	$7,894,294	$13,448,645	$5,639,454	$26,982,393
Percent of Increase	155	65	18	47

[1] These figures, for the school year 1943-1944, include the emergency cost-of-living grant, amounting to $13.35 million in this year. If such cost-of-living increases were discontinued, the total net gain to the school districts would be increased by that amount.

The above computation shows a potential reduction of taxes to be raised by school districts of about $27 million, yearly, or $54 million, biennially. Actually, according to the estimated revenues from the taxes to be dedicated to school purposes, there would be an additional

$8 million, available for biennial distribution to school districts for special purposes, as explained in the following paragraph.

To finance this program, it is proposed that there be imposed a state-collected general sales and compensating use tax at the rate of 2½ percent, as explained in Part II of this report. Also, that the presently imposed taxes on gross receipts of public utilities and on gross premiums of insurance companies, not now allocated to firemen's relief and police pension purposes, be dedicated to the support of the public school system. These three tax sources are estimated to yield, in terms of 1943-1945 revenues, approximately $179 million per biennium. The distribution to local school districts on the basis of the proposed formula would amount to $168.75 million per biennium, leaving a balance of approximately $10.25 million. The proceeds from these specially dedicated taxes would also be used for the payment of salaries and expenses to county and assistant county superintendents, county boards, and other minor miscellaneous payments, amounting to $2 million a biennium, leaving a balance of $8 million. This amount would be available, at the discretion of the Superintendent of Public Instruction, for relief of financially-distressed school districts and to take care of those fourth class school districts, where the pupil-teacher ratio or teaching unit of 25 cannot be maintained.

Assuming that the entire $179 million is to be distributed for school district purposes and for county superintendents, et cetera, this sum, in effect, would represent an increase of $59.557 million in state grants to school districts above the amount, including the emergency cost-of-living increases, provided in the 1943-1945 budget. Theoretically, this sum may represent an amount, by which real estate taxes could be reduced, if school expenditures are maintained at the present level. It is quite possible, however, that full realization of this amount may not be attained, since districts may be presently operating at a deficit on the basis of their present revenues, or may be currently unable to offer certain educational services, which the proposed larger grants would permit them to do. It may, however, be assumed that generally it should be possible to give substantial relief to real estate to the extent of a major portion of the above amount. There may be some justification in the suggestion that part of the revenue increase of the school districts be used to abolish the per capita tax, imposed for school purposes, since both this tax and the general retail sales tax would fall directly on individuals. The abolition of the per capita tax would result in an annual reduction in local revenues of second, third, and fourth class school districts, amounting to approximately only $8.8 million. On the other hand, should the various school districts establish a pupil-teacher ratio, used in the state distribution formula as their minimum base, there would be annual savings of approximately $18 million. In order, however, to insure some substantial reduction in the school district real estate tax burden, the present tax limitations for school districts should be reduced to reflect reasonable reductions to be expected in real estate tax rates, as a result of the increased school revenues.

Although it is not an essential feature of the proposed school formula, a system of *county school districts* is a fundamental requirement for better administration of the school system of the Commonwealth and a more equitable distribution of state-collected, locally-paid taxes. School districts of the first and second classes are generally considered to be large enough to continue to operate as individual school districts. However, third and fourth class school districts do not constitute an economical unit for school administration. It is proposed for those districts that the county be established as a unit of school administration.

Some of the advantages of the proposed school formula and county unit plan are enumerated below:

(1) A broadly-based tax would be provided in support of a state-financed program of minimum state-wide educational standards. This program would also provide funds for some equalization of business taxes and for substantial relief of taxes on local property.

(2) Educational opportunities would be equalized throughout the state and among the counties to the benefit of children in the less prosperous areas. Present school districts, with relatively small resources, would be assured of an adequate educational program, while those districts, desiring higher standards, could attain such standards at their own expense. The number of districts, which appeal annually for special aid to financially distressed districts in order to avoid the necessity of closing or curtailing their school facilities, would be greatly reduced.

(3) Under the county unit plan, school funds could be used to better advantage to establish and maintain school plants, where most needed. Duplication of school plants, teaching staffs, and collateral activities would be reduced.

(4) The county school unit would collect all school taxes and make possible a reduction in the cost of collection by saving salary expenditures for tax collectors, secretaries, treasurers, auditors, and solicitors in districts, where the amount of school business does not warrant these services.

Recommendations:

1. That for the purpose of giving relief to the public school system and of bringing about a reduction in taxes on real estate throughout the Commonwealth, state dedicated taxes for school purposes to provide $1,600 per teaching unit be raised by a state sales and compensating use tax at the rate of 2½ percent and by a shift of the utilities gross receipts tax and the insurance premiums tax (state collected) to the use of local school districts.

2. That the proceeds from the state dedicated taxes for school purposes be apportioned among the four classes of school districts on the basis of a $1,600 per teaching unit with the following teacher-pupil ratios to be established, viz: in first class districts, 33 pupils per teacher, in second and third class districts, 30 pupils per teacher, and in fourth class districts, 25 pupils per teacher.

3. That the county be established as the unit of school administration, except that municipalities, having a population of more than 30,000, shall constitute separate school districts.

4. It is the opinion of the Tax Advisory Committee that a reduction in the revenue requirements of individual school districts, which will necessarily result from the proposed plan, will permit a substantial reduction in the school district levies on real estate. This can only be assured by establishment of a ceiling by the General Assembly, on the amount, which may be assessed and collected from real estate for school purposes.

CHAPTER 3

REALLOCATION OF GOVERNMENTAL FUNCTIONS

An examination of the expenditures for various governmental functions by the units of government in the Commonwealth [1] indicates that municipal functions, as distinguished from county functions, are essentially different in character from those, administered by the Commonwealth, and are of a nature, which can be best administered at the local level. County functions in the Commonwealth, on the other hand, are for the most part shared with the Commonwealth, and in the case of several functions, the county is, in fact, merely an agent of the Commonwealth, although contributing a relatively high portion of its total revenues to functions, over which it has relatively small control or jurisdiction. At the same time there are certain functions, which the state has assumed in full, but which could probably be more effectively administered at the county level with joint participation by the Commonwealth and the counties in both regulation and costs. These are the areas in which transfers of functions can best be consummated to provide a more logical distribution of financial and administrative responsibility without weakening the jurisdictional position of local and state governments.

Public Assistance

Pennsylvania has had experience with both locally-administered and state-administered public assistance. Up to August, 1932, the counties of the Commonwealth were completely responsible for the costs and administration of all public assistance, except mothers' assistance, for which the Commonwealth had assumed partial responsibility as early as 1913. In the depths of the depression in 1932, however, the State Emergency Relief Board was created to administer emergency relief through the poor districts. Two years later, the Commonwealth initiated its second venture into the so-called "categorical" assistance field of local responsibility by providing state-aid for the needy blind and aged.

A more drastic step was taken in 1937, at which time the Common-

[1] See Report No. 1 of the Local Government Commission, entitled "Costs of Government in the Commonwealth of Pennsylvania," published September 1, 1944.

wealth took over the entire public assistance field, assuming the complete responsibility for all administration and costs. Although County Boards of Assistance were established, a careful reading of the Act of June 24, 1937 (P. L. 2051), as amended by the Act of June 26, 1939 (P. L. 1091), shows that the authority of these boards is largely illusory. In actual practice, the members of these boards have had little opportunity to influence policy or exercise discretion. Regardless of the county board organization, the public assistance program in Pennsylvania is in effect state-controlled.

Administration of public assistance has become a sharp controversial issue in recent years. It is noteworthy, however, that Pennsylvania is unique in respect of its present system of complete responsibility on the Commonwealth for administration and costs of all public assistance. No other state of comparable size has been fit to follow the Pennsylvania pattern. The practice in most other states is based on the belief that public assistance is best administered locally, where the financial needs of each applicant can be more quickly and accurately ascertained and checked periodically. Such general acceptance of this point of view, as evidenced by actual practice in most all other states, not only cannot be ignored, but indicates that there may be a major error of policy in the Commonwealth's position.

In 1936 an experiment with local administration of relief was conducted in six selected counties, representing different sections and conditions in the Commonwealth. Members of the Goodrich Committee of the General Assembly visited the counties and reported steadily increasing confidence in local administration of relief, based upon greater public trust in local determination of local problems by those closer to, and more familiar with, local conditions and needs.

A report, made by the Joint State Government Commission in 1940,[1] revealed that members of the County Boards had become discouraged in their efforts to adapt the relief program to their individual districts. Under such circumstances, other citizens, who were less directly concerned with the problem, naturally lost interest. With the Commonwealth's assumption of full financial responsibility, as well as administrative control, the Commission felt that many public-spirited

[1] See the Joint State Government Commission's "Report on Relief," prepared for the General Assembly of the Commonwealth of Pennsylvania, published January, 1941.

citizens, previously concerned about the cost or manner of administration of relief, became apathetic. It was the Commission's belief that with the return of administrative and financial responsibility for public assistance to the local units of government, the citizenry could be made more conscious of both the costs and administrative problems of relief and unemployment.

All these considerations apparently lead to the conclusion that public assistance should be a local responsibility, locally administered by those familiar with local problems and local conditions. Administrative responsibility is necessarily weak wthout financial responsibility. Therefore, the counties should be required to contribute materially to the costs of public assistance, with the Commonwealth fixing certain minimum standards and providing a substantial portion of the costs to assure a uniform state-wide program.

The present problem, therefore, is to restore the principle of local responsibility for the administration and financing of public assistance, without losing any of the benefits, achieved during the past decade under state-wide standards and administration. This can be accomplished by joint state-local responsibility in administration and in financial support of public assistance, whereby the state's Department of Public Assistance determines the general state-wide principles, state-wide policies, and state-wide minimum standards for all programs of public assistance, gives consideration to the requirements of the state and the various counties, and establishes rules, regulations, and standards, while local administration becomes the responsibility of local authorities. Local administration would be performed by county boards of public assistance, whose members are locally appointed by, and responsible to, the county government.

The financial requirements of the county boards of public assistance under this program would be met by a basic contribution by the counties, with the balance to be supplied by the state. The development of a formula, which will provide a relatively equitable contribution by the counties for public assistance, is not an insuperable problem, though it will require thoughtful consideration, based on experience in other states. Assessed valuations of various counties, equalized to a state-wide standard of 100 percent valuation, would provide reliable data as to the relative ability of each county to finance its fair share of the costs of public assistance. With this equalization, the counties could be required to levy a specified tax rate on real estate for public assistance and any amounts required, above that levy, could be provided by the state.

The basic contribution of no one county should in any case be less than 30 percent nor more than 50 percent, on the assumption that the average contribution of the counties would approximate 40 percent of the total cost of non-institutional welfare, including public assistance, foster home care, and other forms of child welfare, as well as all cases of relief, not cared for in state institutions. This would involve a biennial expenditure, based on current trends, of approximately $32 million by the counties and a reduction, in the same amount, of expenditures for public assistance from the state's General Fund.

The range of 30 to 50 percent for county participation would take care of the counties, which have greater needs and less ability to pay for public assistance than the average. Such counties will, of necessity, need a larger share of state funds than the counties in more fortunate economic circumstances.

In order to facilitate the assumption by the counties of their share of financial responsibility for public assistance, they would be assisted by new revenues from the proposed new state net income tax on unincorporated business, as recommended in Part II of this report under New Sources of Revenue. The proceeds from this tax, which would be at the same rate as the state corporate net income tax, would be used primarily for county purposes so as to enable counties to bear part of the cost of public assistance and the amount, not so needed for this purpose, would be allocated to municipalities.

It is estimated that this tax, at the present corporate net income tax rate of 4 percent, would yield $25 million biennially.

Recommendations:

1. That all non-institutional welfare, including assistance, be declared the joint responsibility of the state and the counties, administered through the county commissioners, with the State Department of Public Assistance setting standards and the counties contributing a material portion of the amounts required.

2. That a state net income tax be imposed on unincorporated business at a rate equal to the rate, imposed on incorporated business under the Corporate Net Income Tax Act, and that the revenues from this tax be used first for county purposes so as to enable counties to bear part of the cost of public assistance and the amount, not needed for this purpose, be allocated to municipalities.[1]

Institutional Welfare

Welfare functions, not included in the discussion immediately preceding, relate primarily to the institutional care of indigents. Under the provisions of the original Goodrich Act of 1937, such cases were generally the responsibility of the counties and the Commonwealth, each maintaining their separate and distinct institutions. The amended "Mental Health Act," which became effective on June 1, 1941, whereby the state assumed responsibility for mental patients and all mental hospitals, formerly under the jurisdiction of the county institution districts, created a confusing administrative problem. This confusion was not limited to the administration of the particular institutions, but extended to the determination of responsibility, with the result that very thin and confusing distinctions have developed, shadowy in many cases, with unnecessary duplication of facilities and services.

The transfer to the Commonwealth of all institutional care, including the properties, would eliminate the existing confusion and duplication. This transfer would fix completely upon the Commonwealth the responsibility, not only for the costs, but for the standards of a public welfare service which, because of its requirements of scientific and medical treatment, warrants state-wide and uniform standards. The transfer would also avoid duplication of highly expensive equipment, facilities, and personnel in numerous local areas, and make for greater efficiency and more effective services. The state's assumption of the costs of all institutional care would constitute an additional burden on the General Fund of about $22 million biennially, thereby relieving the demands upon county revenues to the same extent.

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[1] This recommendation is repeated and discussed further in Part II of this report under "New Sources of Revenue."

Recommendation:

1. That institutional welfare costs of county institution districts be the exclusive responsibility of the state, both financial and administrative, with such transfers of property as may be required.

Judiciary

The judicial function, which in Pennsylvania is an essential state function, is presently administered jointly by the Commonwealth and the counties, with the counties in 1942 assuming about 84 percent of the costs, including those for the constitutional, county "fee" officers. No jurisdiction over the courts is vested in the counties, but they are required by law to furnish such employes, office supplies, services, and quarters as the judges in each county may request.

The court employes, paid by the counties, include criers, tipstaves, jurors, stenographers, court reporters, and secretaries to judges. The counties also pay the fees of the minor judiciary and constables and provide office supplies and equipment and other services. This division of costs between the state and the counties, without division of responsibility, is an anomaly, which cannot be justified. All costs for the courts of common pleas, of oyer and terminer, quarter sessions and orphans' courts in all counties, the municipal court in the City of Philadelphia, and the county court in the County of Allegheny, and the expense, now incurred by the counties in connection with minor judiciary and constables, should be transferred to the Commonwealth. The counties, however, should continue, as a matter of economy, to provide the existing housing quarters for the courts, until such time as new construction may be required.

It is estimated that the transfer of the judicial function and the fees of the minor judicial officers and constables would relieve the counties of costs of about $15.5 million biennially. These costs would be assumed by the General Fund of the Commonwealth.

Recommendations:

1. That there be transferred to the Commonwealth from the counties all expenses, involved in the employment of criers, tipstaves, jurors, stenographers and secretaries to judges, court reporters, and supplies for judges of the courts of common pleas, of oyer and terminer, quar-

ter sessions and orphans' courts, as well as the municipal court in the City of Philadelphia, and the county court in the County of Allegheny, with counties furnishing existing housing quarters for the courts.

2. That the expense, now incurred by counties in connection with minor judiciary and constables, be placed upon the state.

Corrections

The Commonwealth and the counties jointly exercise correctional functions, which includes the maintenance of prisons, workhouses, reformatories, and industrial farms. In 1942 the counties supported about 58 percent of the cost of corrections, including the maintenance of penal offenders in state and semi-state institutions. At the present time penal offenders, sentenced by the county courts to state or semi-state institutions, are maintained at the expense of the county, which pays a per diem charge to the Commonwealth. If the courts deem it advisable to commit certain offenders to state or semi-state institutions, there seems little justification for considering the maintenance of such offenders as a matter of local concern. The correctional function, in its relation to this type of offender, is a matter of the general interest and can be conducted properly only at the state level.

It is logical, therefore, that the state take over the entire costs and responsibility, insofar as they apply to penal offenders, committed to state and semi-state institutions, from the county, which has little jurisdiction over either the judicial or correctional aspects of this problem.

The transfer to the state of the costs of the maintenance of penal offenders in state and semi-state institutions will relieve the counties of biennial costs estimated at $7 million.

Recommendation:

1. That the state bear the cost of maintenance of penal offenders in state and semi-state institutions (without any charge to the counties).

Revenue Shifts to Counties

In addition to receiving the proceeds from the proposed state tax on unincorporated business for public assistance purposes, as recommended earlier, certain present tax revenues of the state should also be shifted to the counties. It has been recommended in Part II of this report that all taxation of personal intangibles be transferred from the state to the county and the county personal property tax be extended to cover the stock of state and federal building and loan and savings and loan associations. It has been further recommended that both the tax on writs, wills, and deeds and the fee on marriage licenses, now collected by the counties for the state, be changed to a county tax and fee. These three measures would result in a biennial increase of county revenues of approximately $9.6 million, of which $8.4 million would be raised by taxation of corporate and municipal loans by the counties in place of the state. The extension of the personal property tax to building and loan association shares would produce about $600,000, as would the additional revenue retained by the county from the writs, wills, and deeds tax and marriage license fees. Unlike the revenues from the proposed tax on unincorporated business, these revenues, shifted to the counties, would be for general purposes rather than a specific function.

Recommendations:

1. That the tax on writs, wills, and deeds, and the fee on marriage licenses be changed from a state tax and fee to a county tax and county fee, respectively.

2. That a survey be made to ascertain whether other similar documentary transactions should be subjected to the county tax.

3. That the corporate loans tax be abolished and the obligations, now taxed thereunder, be subjected to the (county) personal property tax.

4. That the municipal loans tax be abolished and the obligations, now taxed thereunder, be subjected to the county personal property tax.

5. That a provision, imposing a tax similar to that, formerly imposed by the Act of 1897 and applicable to both state and federal building and loan and savings and loan associations, be incorporated in the county personal property tax act.

Sanitation

In the interest of improving and strengthening local government, a transfer of function is recommended within the range of local governments. Townships and boroughs are too small to cope adequately with problems of sanitation. Furthermore, these problems cannot be confined within city limits. Effective co-operation between these units of government on health and sanitation is at best difficult, creating jurisdictional and administrative problems. A larger unit of local government, encompassing urban as well as rural units, is in a better position to deal with certain problems of sanitation. Municipal authorities should be encouraged to construct and operate trunk sewers and sewage disposal plants on a fee basis through the co-operation of the various municipalities, constituting a drainage area. Since the operation of these services would be financed on a fee basis, it would not only relieve local taxes from this cost, but would also enable municipal authorities to finance the capital outlays for these services by means of revenue bonds, thus leaving the general borrowing power of the municipalities unaffected.

Recommendation:

1. That encouragement be given to the development of municipal authorities to construct and operate trunk sewer and sewage disposal plants on a rental basis, with capital expenditures financed on a revenue bond basis.

Health

General health hazards, such as communicable diseases, and some health services, such as the collection and preservation of vital statistics, cannot be limited by political boundaries. Consequently, it is desirable that certain of these problems of state-wide interest, namely, communicable diseases and vital statistics, be administered at the state level. General experience has found local health administration defective in respect to these items and their assumption by the state would be welcomed, as a desirable allocation of this function to its proper sphere.

Recommendation:

1. That the health problem, so far as it relates to communicable diseases and vital statistics, be declared a state function.

State Funds to Municipalities for Highway Purposes

Although all local units of government in Pennsylvania, except school and institution districts, spend funds for highway purposes, counties and second-class townships are the only direct beneficiaries of state funds for such purposes.

The normal 3 cent tax on gasoline, now levied for highway purposes, is partially dedicated (½ cent per gallon) to counties, on the basis of the average amount of gasoline, sold within each county during the three year period, 1928-1930. The use of these dedicated funds is restricted to the construction and maintenance of highways and bridges, and the payment of any indebtedness, incurred for these purposes. Counties may also grant part of the liquid fuels tax receipts, or other county revenues, to cities, boroughs, and townships within their jurisdiction, for municipal highway construction and maintenance. These grants are not mandatory nor is there a regular formula for the distribution by the counties of such grants to the municipalities. Consequently, there are many instances of inequitable distribution and, furthermore, there is no assurance that the grants by the county to its municipalities will be either made or continued from year to year on the same basis or on some other basis.

The counties' share of the liquid fuels tax dates from the first levy of the tax in 1921, when Pennsylvania's modern highway program had its inception. Since that time, the state has relieved the counties of the costs of maintenance of many of their roads by making them part of the highway system of the Commonwealth. Furthermore, the state, under the Act of May 28, 1943 (P. L. 796), must assume the costs of *all* county roads on the petition of the county commissioners, so that, with the exception of past debt service, incurred by counties for highways, any county can relieve itself of all expense for constructing and maintaining highways.

Second class townships now receive grants from the state's Motor License Fund, amounting in 1943-1945 to $7 million. All other municipalities must assume the full costs of their streets and roads, many of which are vital parts of the Commonwealth's highway system, without regular or continuing aid from the state. In 1942 the Commonwealth assumed 53.7 percent (excluding liquid fuels tax revenues, returned to counties and highway grants to second class townships) of total expenditures for highways; counties and second class townships, both of which receive substantial highway aid from the state, 8.5 percent of the total; and cities, boroughs and first class townships, which receive neither liquid fuels tax funds nor regular state grants for highways, 37.8 percent of the total expenditures for highways within the Commonwealth.

In view of the above circumstances, a more equitable distribution of the tax funds for highway purposes seems warranted. The present distribution of the liquid fuels tax to counties and highway grants to second class townships is quite irrational. The counties now have the option of turning over to the state all responsibility for the maintenance and further construction of county roads, while the preference, given to one type of municipality—second class townships—is not in keeping with the heavy demands on real property owners in all other municipalities for the support of streets, roads, and highways. Furthermore, the uncertain biennial grants to second class townships are not a form of revenue, which can be depended upon to provide stability to the revenue system of second class townships.

It is proposed, therefore, that highway aid to local governments be revamped and that both the present formula for distribution of the local share of the liquid fuels tax and highway grants from the Motor License Fund be eliminated. In place of these, one cent per gallon of the present three cent per gallon tax on gasoline should be dedicated to municipalities, that is cities, boroughs, towns, and townships of the first and second classes, according to a legislative formula, based equally on population and miles of road, maintained by such municipalities. The use of such funds would be limited to the construction and maintenance of roads, bridges, and tunnels and related indebtedness.

To eliminate the inequities, which now exist in regard to the payment of land damages in connection with state highways in cities, it is proposed that the Commonwealth should be granted the authority to lay out and construct state highways, bridges, and tunnels, paying all expenses, including property damages, without local participation, except by local consent, as is now the case in regard to such state construction in boroughs and townships.

These proposals would result (in terms of 1943-1945 revenue) in a biennial loss of $11.3 million of liquid fuels tax funds to the counties and $7 million in highway grants to second class townships. Municipalities, however, would receive $22.6 million of liquid fuels tax funds, while the Motor License Fund would suffer a net loss of only $4.3 million in revenue, available for appropriation. This sum, however, would still be earmarked for highway purposes, as outlined above. It is estimated that the loss of highway grants by second class townships would be nearly compensated by their share of the liquid fuels tax. Municipalities would also share in the proposed net income tax on unincorporated business, as described in the earlier section of this chapter.

Recommendations:

1. That appropriations from the liquid fuels tax be made available in the amount of one cent per gallon to cities, boroughs, towns, and townships, distributable one-half on the basis of population and one-half on the miles of roads, such funds to be used for highway, bridge, and tunnel construction and maintenance and amortization of indebtedness incurred for road purposes. These grants would be in lieu of present appropriations from the Liquid Fuels Fund and the Motor License Fund to counties and townships of the second class.

2. That the state be granted authority to lay out and construct state highways, bridges and tunnels, paying all expenses, including property damages, without local participation, except by local consent.

Summary

When all proposed changes in the tax structure and all recommendations for reallocation of functions and their costs are fitted into one pattern, as conceived by the Tax Advisory Committee, it is evident that the declared objectives of the Committee would be fulfilled.

There would be a net biennial revenue increase (in terms of 1943-1945 revenues) of $141.4 million, available for appropriation by state and local governments. This would provide a net biennial increase in local revenues of $110.7 million, to be distributed among school districts, $59.6 million; counties, $35.8 million, and municipalities, $15.3 million, for potential relief of real estate taxation. Desirable reallocations of functions between the Commonwealth and its political subdivisions would be accomplished, strengthening both state and local governments. The basis of state-local taxation would be broadened by the introduction of new broadly-based taxes, dedicated to specific local purposes, and, finally, in addition to the elimination of many existing inequities and discriminations in the Commonwealth's present General Fund tax structure, there would be a net increase of $35.0 million in this fund's revenue, available for appropriation.

The state's Motor License Fund, under the proposed distribution of liquid fuels tax monies and the elimination of highway grants, would show a net decrease of $4.3 million, so that the net biennial increase to the state would amount to $30.7 million.

The changes in the General Fund tax structure would alleviate the present unduly high tax burden on private enterprise and taxes on business and industry would be made more comparable with those in other industrial states. All these results, in combination, would greatly increase the possibility of attracting new capital into the Commonwealth for the development of new enterprises, as well as expansion of existing industries. They would also greatly encourage maximum production and employment in the postwar years, assuring a high degree of prosperity. They would encourage the conversion of the distressed areas to more highly diversified industrial activities, permitting the development of strong and virile communities. Finally, they would be the surest means of effecting the reversal of current unfavorable economic trends, which clearly indicate that Pennsylvania has been losing its position as a leading industrial state of the union.[1]

[1] See Report No. 10, of the Joint State Government Commission, entitled "The Economic Resources and Related Tax Problems of the Commonwealth of Pennsylvania," published January 3, 1945.

CHAPTER 4

RECOMMENDATIONS WITH RESPECT TO LOCAL TAX ADMINISTRATION AND FINANCIAL PRACTICES

The chief problems of local tax administration are those concerned with the assessment and collection of the real property tax. Other problems exist also with respect to budget procedure, public reporting of financial conditions, and weaknesses in the control of the issue of long term bonds.

Local Assessment Practices

With respect to the basis, on which real property is assessed, there is frequent and great difference between the valuation of comparable property among the various assessing districts in the county and within these districts themselves. This requires the improvement of assessment administration, as well as improvement of the legal provisions for uniform valuation, and clarification of the definition of assessable property, separation of the functions of assessment and equalization, abolition of triennial assessments, provision against over-frequent appeals from assessed valuations, and improvement of the timing of assessments.

It is accordingly recommended:

1. That the General County Assessment Law (Act of May 22, 1933, P. L. 853) be amended by eliminating the provisions that assessments of real estate shall be at the actual value thereof, substituting therefor a provision that such assessments shall be uniform within the county, and by the addition of a further provision that in all cases of appeal by a taxpayer to the courts of the Commonwealth, where the question is raised, the courts be required to ascertain and determine the prevailing ratio between market and assessed values within the county, and whether such ratio has been uniformly applied. Other assessment laws, relating to cities of the 1st, 2nd, 2nd class A, and 3rd classes, should be amended in a similar manner.

2. That permanently affixed machinery, forming part of real estate, be included in the assessed value of real estate.

3. That in counties of the 1st to 4th classes locally elected assessors be eliminated and that the bodies for assessment and for equalization through appeal be separated; that the custom of tri-

ennial assessments be abolished and allowance be made for appeals not oftener than once in three years, unless the assessment is changed and except under special conditions.

4. That timing of assessments be co-ordinated with the fiscal year.

5. That legislation be enacted, making it mandatory that all assessment records of properties, taken by virtue of the exercise of the power of eminent domain, shall be made a part of the record in any proceedings to determine the damages, sustained by reason of property taken, injured, or destroyed.

Collection of Local Taxes

Collection of local taxes in Pennsylvania, with the exception of cities and several counties, is performed by locally elected collectors on a commission basis. Pennsylvania is one of only eleven states, where local taxes are collected by local collectors. This system is not only more costly, but has produced higher tax delinquencies than prevail generally. Furthermore, municipalities encounter great difficulties in their efforts to collect on delinquent taxes because of the limited title, which they can transfer to prospective purchasers through a tax sale. There is need also for the establishment of a uniform system of tax payments on a quarterly basis and uniform system of penalties and discounts.

It is accordingly recommended:

1. That the county be made the unit for the billing and collection of all local taxes.

2. That compensation of collecting officers be based on salary, not on commission.

3. That the election of all local tax collectors be ended.

4. That legislation be enacted to govern the sale of property for delinquent taxes so that title, freed from liens and encumbrances, may be transferred to the purchasers of properties, sold at county treasurer's sales.

5. That all discounts, charges, and penalties be made uniform and the installment method of tax payments be placed on a quarterly basis.

Local Financial Practices

There is also need for strengthening of the law with respect to budgeting and reporting in order to assure that budgets may not be finally adopted until a reasonable time has been given for public inspection and for appeal with respect to such aspects of the budget as may, be properly inquired into by the Court of Common Pleas. With respect to third class cities, moreover, there is need for strengthening the provision for reporting of the controllers' audit in the same way as presently provided in the case of the county controllers' audit. There is need, also, to strengthen the provisions against possible abuse in issuance of long term bonds for funding and refunding of the debt of local units of government and for issuance of bonds against delinquent taxes.

It is accordingly recommended:

1. That no county, municipal, or school district budget may be finally adopted until ten days after the said budget in its final form has been made available for public inspection and due notice thereof given.

2. That any taxpayer of the tax levying district may, within fifteen days after the final adoption of such budget and the fixing of the tax rate, appeal to the Court of Common Pleas, and upon such appeal it shall be the duty of the court to inquire into the legality, validity, and reasonableness of each item, set forth in the budget, which is made the subject matter of objection.

3. That the report of the controller of the financial affairs of 3rd class cities be filed in the office of the prothonotary of the county and that taxpayers be given an opportunity to appeal from such audit in the same manner as now provided by law for appeals from county controllers' reports.

4. That the purposes, for which long-term bonds may be issued by local units of government, be limited to the financing of capital outlays, past or prospective, not heretofore made part of the bond issue.

5. That authority be granted local units of government to issue ten-year bonds against seventy-five percent of delinquent taxes of the preceding five years, such bonds to be repaid out of delinquent tax collections, and that, in any event, such bonds shall be full faith and credit bonds, within the debt limitations, prescribed by the Constitution, of the issuing political subdivision.

PART IV

PROJECTION OF GENERAL FUND REVENUES AT SELECTED LEVELS OF STATE AND NATIONAL INCOME

CHAPTER I

RELATION OF PENNSYLVANIA REVENUES TO STATE AND NATIONAL INCOME

Prior to 1935 revenues of the General Fund of the Commonwealth, especially tax revenues, showed little direct correlation with state and national income, either in total, or, in most cases, by individual sources. The relation of General Fund revenues to state income was further obscured by the reporting system of the Commonwealth, which recorded revenues according to the year of receipt without regard to the year in which the taxes were levied.

Since the enactment of new taxes on corporate net income and consumption items in 1935 and 1936, the relation of revenue to state and national income has become more direct, although the Commonwealth's experience with these taxes has not been sufficient as yet to forecast, with assurance, the reaction of these taxes to all possible contingencies, resulting from sudden or severe changes in economic trends.

It has been possible, however, to secure for the years, 1936 to 1941, (the last year for which the data are reasonably complete) actual tax yields for many of the taxes, namely, those on corporate net income, capital stock, shares of banks and trust companies, corporate loans, gross receipts of public utilities, gross premiums of insurance companies, and lesser subjects. Furthermore, consumption taxes, which are collected on a current monthly basis, reflect, in themselves, a direct relation to economic conditions without further qualifications or adjustment. In addition to the more precise analysis, made possible by use of actual yield data for the taxes, as specified, due weight has been given to certain extraneous factors, which have influenced tax revenues in recent years and have a bearing on estimates of General Fund revenues for the postwar years.

All these various considerations have been carefully weighed in the final process of predicting the probable revenues of the General Fund at four possible levels of national income, *i.e.,* national income (payments by states) of $75 billion, $100 billion, $125 billion, and $150 billion. These assumed levels range from the minimum to the maximum national income, now being predicted by various authorities for the first postwar decade. In terms of Pennsylvania's state income, the assumed levels are the equivalent of approximately $6.1 billion, $7.7 billion, $9.2 billion, and $10.8 billion.

State and National Income Series

The economic index of national income, to which General Fund revenues of the Commonwealth have been related in this report, is the income payments to individuals—by states, prepared by the United States Department of Commerce. There are many concepts of national income, of which the principal ones, developed by the Department of Commerce, are gross national product, national income—by distributive shares (the most commonly used national income figure), income payments to individuals, and a related series, income payments to individuals—by states, which differs from income payments to individuals by the amount of certain payments, which cannot be distributed by specific states. The relation of these series for recent years (1940 to 1944) is illustrated in the following table:

NATIONAL INCOME INDEXES—1940-1944

(in billions of dollars)

Year	*Gross National Product-or Expenditures* [1]	*National Income by Distributive Shares*	*National Income Payments to Individuals (Total)*	*National Income Payments to Individuals (By States)* [2]
1940	97.1	77.6	76.2	75.9
1941	119.6	96.9	92.7	92.3
1942	152.1	121.6	116.6	114.8
1943	186.5	147.9	142.3	138.1
1944	196.4[3]	158.0[3]	154.6[3]	142.5 (Estimated)

[1] Includes business tax and non-tax liabilities, depreciation and depletion charges, other business reserves, capital outlays, charged to current expenditures, and inventory revaluation adjustments, which are eliminated from the National Income by Distributive Shares.

[2] A difference exists between the total of income payments and the aggregate total for 48 states and District of Columbia because certain items cannot be distributed by states, such as payrolls of the Army abroad, etc.

[3] As estimated by U. S. Department of Commerce.

Income payments to individuals differ from national income, the sum of distributive shares accruing to individuals for participation in productive activity, due to the exclusion of undistributed profits of corporations and contributions to social insurance funds and the inclusion of transfer payments, such as the government's share of allowances to soldiers' dependents.

Total income payments to individuals are comprised of salaries and wages, net of payroll deductions for social insurance; other labor income such as pensions, compensation for injuries, direct and work relief, and social insurance benefits; entrepreneurial income, representing the net earnings, before owners' withdrawals, of unincorporated businesses, including farmers; and, dividends, interest, and net rents and royalties, received by individuals. The income payments are distributed among the states on a "where-received" basis with the exception of non-distributable payments, as noted above.

It is apparent from the previous table that in a normal pre-war year (1940) the differences in the totals of national income, income payments, and income payments by states, are relatively unimportant. The prosecution of the current war, however, has intensified the divergence among the series, due chiefly to increased corporate savings, which are included only in the national income series, and to increases in non-distributable income payments, consisting largely of payments to those in service abroad, which are included only in total income payments to individuals. It appears reasonable, however, to assume that after the end of the war these differences will be minimized and the various series will again show fairly comparable totals, so that the total of income payments, by states, will reflect a national income of about the same amount.[1]

Income payments by states, therefore, provide a series, related to national income, in which Pennsylvania's share has been more or less accurately determined and related to the aggregate of income payments, by states.

The 1936-1944 income data, upon which the computations of the relation of General Fund revenues of the Commonwealth of Pennsylvania to state and national income have been made, are as follows:

[1] This assumption would not hold in periods of exceptionally large payments of direct and work relief, when total income payments—to individuals—would probably exceed national income—by distributive shares.

NATIONAL INCOME PAYMENTS TO INDIVIDUALS—BY STATES

(in billions of dollars)

Year	Total for 48 States and District of Columbia	Total for Pennsylvania	Percentage—Pennsylvania's Share of Total
1936	67.957	5.808	8.55
1937	72.275	6.173	8.54
1938	66.117	5.441	8.23
1939	70.747	5.829	8.24
1940	75.892	6.225	8.20
1941	92.269	7.404	8.02
1942	114.762	8.723	7.60
1943	138.101	9.921	7.18
1944 (Estimated) ..	142.500	10.231	7.18

Relation of Pennsylvania Experience to Selected Levels of Income

The actual years or average, thereof, approximating the possible postwar national income levels of $75 billion, $100 billion, $125 billion and $150 billion are:

Possible Post-war National Income Level—Income Payments—by States (in billions)	*Actual Level of Income Payments—By States, and Period* (in billions)
$75	$75.9 (1940)
$100	$103.5 (Average— $92.3—1941) $114.8—1942)
$125	$126.4 (Average—$114.8—1942) $138.1—1943)
$150	$140.3 (Average—$138.1—1943) $142.5—1944 Estd.)

It is apparent from the above table that the Commonwealth has already had revenue experience at national income levels, approximating $75 billion, $100 billion and $125 billion, and approaching $150 billion (income payments, by states).

Revenue collections at these approximate national income levels have been established by using the actual figures for 1940, the average of 1941 and 1942, the average of 1942 and 1943, and the average of 1943, actual, and 1944 estimated. Despite certain abnormal conditions prevailing since 1941, such as restrictions on certain consumption goods, heavy federal taxation of corporations, and tremendous increases in income payments, far above the peak of former experience, the tax collections for these years provide a reasonable basis for estimating tax revenues at comparable levels of income in the postwar years.

Relation of the Commonwealth's Fiscal Year to Calendar and Tax Years

The Commonwealth's records of revenue collections are kept on the basis of the state's fiscal year, beginning June 1 of the first calendar year and ending on May 31 of the following calendar year. Major tax items, such as the corporate net income tax, etc., are collected on March 15 or April 15 of the year following the calendar year, for which the tax returns are filed, so that tax collections in the Commonwealth's fiscal year, for example, 1943-1944, are related directly to the business operations and economic factors of the first calendar year, 1943. Tax yields and revenues, therefore, are hereafter discussed on the basis of the calendar or taxable year. Consumption tax revenues, although collected currently, are treated in the same manner, but for a different reason. The current collections for the fiscal year, June 1, 1943 to May 31, 1944, for example, bear the following relation to the calendar year, 1943.

Period for Which Tax Is Collected		Period in Which Tax Is Collected	
Year	*Month*	*Year*	*Month*
1943	1. May	1943	1. June
	2. June		2. July
	3. July		3. August
	4. August		4. September
	5. September		5. October
	6. October		6. November
	7. November		7. December
	8. December	1944	1. January
1944	1. January		2. February
	2. February		3. March
	3. March		4. April
	4. April		5. May

It can readily be seen that the collections of the fiscal year, which include eight months' collections of the first calendar year, adequately represent the consumption tax yields for that calendar year and, consequently, can be taken as the taxable year, as defined, for purposes of this report.

On the basis of the above assumptions, Table E has been prepared in order to provide revenue figures [1] for the Commonwealth from actual experience at national income levels, which are approximately the same as the possible postwar levels of national income (payments by states). The Commonwealth revenues, presented in

[1] General Fund revenues, referred to in this section of this report, are always exclusive of federal grants and of all transfers other than liquor store profits.

Table E, include only such taxes and tax rates as will be effective under existing laws of the Commonwealth in the 1945-1947 biennium. Consequently, the revenues, reported for the taxes on loans, shares, and gross receipts are from these taxes at their *normal* rates, while revenues from the state personal property tax and the mercantile license tax are excluded in entirety. However, no adjustment of capital stock tax revenues has been made (in Table E) in connection with the manufacturers' exemption, which by law is to be restored at the beginning of the first year following the cessation of the current hostilities.

TABLE E

COMMONWEALTH OF PENNSYLVANIA

ACTUAL GENERAL FUND REVENUES[1] RELATED TO VARIOUS LEVELS OF NATIONAL INCOME PAYMENTS —BY STATES (EXCLUDING RECEIPTS APPROPRIATED FOR SPECIAL PURPOSES, FEDERAL GRANTS, AND TRANSFERS OTHER THAN LIQUOR STORE PROFITS)

	(in billions of dollars)					
A. National Income (Payments—by States)	75.9	92.3	103.5	114.8	126.4	138.1
B. Pennsylvania Income Payments	6.2	7.4	8.1	8.7	9.3	9.9
C. Year or Yearly Average	*Actual 1940*	*Actual 1941*	*Average 1941 and 1942*	*Actual 1942*	*Average 1942 and 1943*	*Actual 1943*
D. Source of Receipts	(in millions of dollars)					
1. Corporate Net Income Tax	29.6	39.9	45.3	50.7	58.5	66.3[2]
2. Capital Stock Tax	29.1	34.6	35.4[3]	36.1	35.2[3]	34.4[3]
3. Shares Tax	3.5	3.8	3.7	3.6	3.6	3.6
4. Loans Tax	4.9	5.0	4.7	4.4	4.5	4.5
5. Beverage Tax	7.1	8.6	8.6	8.6	9.6	10.5
6. Liquor Tax	8.6	10.5	12.1	13.7	11.9	10.1
7. Liquor Store Profits	18.0	18.0	20.5	23.0	18.2[4]	13.5[4]
8. Cigarette Tax	12.4	13.7	13.7	13.7	14.1	14.6
9. Liquid Fuels Tax	16.5	16.6	14.0	11.4	11.1	11.0
10. Gross Receipts Tax	3.3	3.8	3.9	3.9	4.0	4.1
11. Gross Premiums Tax	6.1	8.4	8.0[3]	7.6	7.9[3]	8.1[3]
12. Inheritance Tax	15.3	13.3	13.3	13.3	15.0	16.6
13. Documentary and Stock Transfer Tax	.6	.6	.6	.5	.7	.8
14. Bonus	.3	.6	.6	.6	.6	.4
15. Penalties	.3	.9	.8	.7	.9	1.1
16. Licenses and Fees	4.2	3.8	4.5	5.2	5.1	5.0
17. Fines	.4	.4	.4	.3	.3	.3
18. Institutional Reimbursement	5.8	6.5	6.0	5.4	5.6	5.9
19. Miscellaneous	1.2	2.1	1.6	1.1	1.3	1.4
Totals	167.2	191.1	197.7	203.8	208.1	212.2

[1] Computed only for taxes and normal tax rates, which under present laws will be in effect after the end of the 1943-1945 biennium.

[2] Increase mainly due to change in tax base, effective in 1943, which eliminated former deduction of federal corporate net income and excess profits taxes eliminated.

[3] Exceptionally irregular collection totals.

[4] Variation is due to Liquor Store profits, not turned over promptly to General Fund in year of accumulations.

Actual experience for four years, of which three have been influenced by wartime conditions, indicates General Fund revenues of $167.2 million at a $75.9 billion national income level and revenues of $197.7 million, $208.1 million, and $212.2 million at national income levels of $103.5 billion, $126.4 billion, and $138.1 billion, respectively. State income payments, in the same order, were $6.2 billion, $8.1 billion, $9.3 billion and $9.9 billion.

CHAPTER II

PROJECTION OF GENERAL FUND REVENUES

The refinement of a long-range projection of General Fund tax revenues in the postwar period is complicated by the uncertainties of the patterns of production, employment, population, and consumption, which will then prevail. Present developments indicate that the decreasing trend, evidenced by the relation of Pennsylvania's income payments to national income payments, by states, may be even more pronounced in the postwar period than was already evident before 1939. A paragraph in *Business Week* of November 11, 1944 points to unfavorable trends, implicit in the Philadelphia regional market area, as follows:

> "Though it's common knowledge that this region's income has trailed the national average during the war because the heavy war industries failed to expand as sharply as elsewhere, it may be even more significant that the district's share of U. S. employment in non-durable lines—textiles, clothing, shoes, food, paper, and printing—also fell off between 1939 and 1943. Losses in these district standbys imply permanent reduction of relative income position as a result of the war."

On the other hand, the return of nearly one-tenth of the population to civilian life and the pattern of consumption habits, established during the war years, may result in a greater rate of increase in consumption tax revenues than indicated by the trends to date.

None of the factors, favorable or unfavorable, however, is so well defined at this time as to permit weighting of a projection more or less heavily than indicated by the trends, established on actual experience from 1936 to 1944, after these trends have been adjusted for such positive factors as federal rationing of gasoline and state rationing of alcoholic beverages.

In projecting consumption tax revenues, the limited experience of the Commonwealth with these taxes comprises a serious handicap. In the years since the enactment of these taxes, with the exception of the liquid fuels tax, there has been a steady increase in total state income, with only a slight recession in 1938, followed by a resumption of the upward trend in 1939. Consequently, the reaction of these taxes to a severe or continued period of decreasing or low state income is unknown and uncertain. Furthermore, the remarkable rate of revenue increase, shown by some of these taxes, is related in an indeterminate degree to abnormal factors, resulting from the current war. An estimate of corporate net income tax revenues also faces the handicap of the changed tax base, first effective for the taxable year 1943, and the absence of complete yield data for the more recent years of exceptionally high national income and unusually high federal taxation.

TABLE F

COMMONWEALTH OF PENNSYLVANIA

ESTIMATES OF GENERAL FUND POSTWAR REVENUES AT VARIOUS LEVELS OF NATIONAL INCOME PAYMENTS—BY STATES (EXCLUDING RECEIPTS APPROPRIATED FOR SPECIAL PURPOSES, FEDERAL GRANTS, AND TRANSFERS OTHER THAN LIQUOR STORE PROFITS)

	(in billions of dollars)			
A. National Income Payments—by states	75	100	125	150
B. Pennsylvania Income Payments	6.1	7.7	9.2	10.8
C. Source of Receipts	(in millions of dollars)			
1. Corporate Net Income	27.0	44.5	63.0	74.5
2. Capital Stock [1]	29.0	31.0	33.0	35.0
3. Shares	3.5	3.5	3.5	3.5
4. Loans	4.5	4.5	4.5	4.5
5. Malt Beverage	7.2	8.4	9.8	11.0
6. Liquor Tax	8.0	11.6	14.3	16.4
7. Liquor Store Profits	18.0	21.0	24.0	27.0
8. Cigarettes	12.0	13.4	14.4	15.0
9. Liquid Fuels	16.0	18.0	20.0	22.0
10. Gross Receipts	3.2	3.8	4.1	4.3
11. Gross Premiums	6.8	7.4	8.0	8.4
12. Inheritance Taxes	14.0	14.0	14.0	14.0
13. Documents and Stock Transfer	.5	.6	.7	.8
14. Bonus	.2	.3	.4	.5
15. Penalties and Interest	.3	.8	.9	1.1
16. Licenses and Fees	4.2	4.5	5.0	5.3
17. Fines and Penalties	.4	.4	.4	.4
18. Institutional Reimbursements	6.0	6.0	6.0	6.0
19. Miscellaneous	1.2	1.3	1.4	1.5
Totals	162.0	195.0	227.4	251.2

[1] No adjustment is made for revenue effect of the restoration of the manufacturers' exemption from the capital stock tax, effective at the end of the war. It is estimated that the manufacturers' exemption will decrease revenues by about $8 million at the national income levels of $75 billion and $100 billion, and by $9 million at $125 billion and $150 billion.

Table F presents the projection[1] of General Fund Revenues into the postwar years at selected levels of national income (payments by states). This prediction is based on data from actual collections, reported in Table E and on rates of increase, which have been adjusted in accordance with observation of actual tax yields[2] from 1936 to 1941 and tax collections from 1936 to 1944.[3]

The estimated rates of increase for some of the lesser taxes are based on the observation of both yields and collections since 1936 and have been modified to eliminate irrelevant irregularities by making a straight-line projection over the range from $75 billion to $150 billion of national income. Supporting data on tax yields and collections and their ratios (base: 1937 = 100) are to be found in the tables, which follow this textual discussion.

The estimate, presented in Table F, shows only three taxes, for which no increase in revenue is anticipated, despite changes in the national income level. These taxes on shares of banks and trust companies, corporate and municipal loans, and inheritance transfers and estates have shown such wide variations in collections, that no satisfactory correlation can be established with economic factors. Inasmuch as the revenues from the taxes on shares and loans are of relatively minor importance, the assumption of a conservative fixed level of estimated revenue is without significant effect on total revenues of the General Fund.

In the case of the tax on inheritance transfers and estates, the estimated level of $14 million reflects the recent experience of the Commonwealth. It is entirely possible, due to the nature of the tax, that the revenue in any given year, regardless of the income level, may greatly exceed the estimated figure, but as a matter of long-range projection, only a reasonable expectation can be accepted for purposes of estimate.

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[1] It is assumed, of course, that there will be no rationing or restriction of consumption items.

[2] Actual collections are taxes (both current and delinquent), received by the Commonwealth in its fiscal year. Tax yields, on the other hand, are revenues, produced from taxes, levied for the calendar year, or the fiscal year, of the subject taxed, without regard to the year in which payment is made. The difference between tax yields and tax collections in most cases is slight, due to collections from delinquent taxes.

[3] The estimates of capital stock taxes have not been modified to take into account the restoration of the manufacturers' exemption from the capital stock tax. (It is estimated that this will decrease annual tax revenues by about $8 million at the $75 billion and $100 billion levels and about $9 million at the levels of $125 billion and $150 billion).

Liquor store profits, as estimated in Table F, show the greatest divergence from the state's actual experience, as reflected in Table E. The variations are the consequence of a delay in 1943 in turning over the accumulated profits of the State Liquor Stores System to the General Fund. Consequently, Table E does not reflect the actual accumulation in that year of liquor store profits, which were later made available to the General Fund. This fact has been taken into consideration in estimating the revenues from this source, reported in Table F.

A more detailed discussion of the general revenue characteristics of each of the major taxes is contained elsewhere in this report, where biennial collections since 1923 are presented, together with comments upon the productive history of the several taxes. Further discussion of the projections for the major taxes, in terms of Pennsylvania's income, are contained in the following pages. For each of these taxes, a trend curve of increase was plotted from actual annual collections, modified by the actual yield experience,[1] when available. For those taxes, which have been affected by rationing, the trend curve of collections was projected on the basis of pre-rationing experience.

Cigarette Tax

The cigarette tax shows a strongly defined reaction to various levels of state income and has the added advantages of reflecting consumption of an item, which was neither rationed nor scarce in the period under consideration. The experience of this tax shows that consumption tends to increase at a regressive rate after a certain definite level of state income is reached. In Pennsylvania's experience, this point appears around a level of state income of $8 billion, or at the $100 billion level of national income. Cigarette tax revenues at the selected levels of income have been estimated, therefore, at $11.7 million, $13.3 million, $14.4 million, and $15 million.

Malt Beverage and Liquor Sales Taxes

The correlation of malt beverage tax revenues to state income shows striking similarity to cigarette tax revenues, although the rate of increase throughout the entire period is more regular for malt beverage tax revenues and there appears to be no point, within the selected range,

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[1] See footnote 2 on preceding page.

at which a regressive rate of increase comes into play. Actual collections from the malt beverage tax can be used for the period, 1936-1944, although they should probably be modified for a slight restriction of the taxable supply. However, general experience, as well as Pennsylvania's experience, shows that periods of relative decreases in the consumption of malt beverages are concurrent with relative increases in the consumption of alcoholic beverages, so that the revenue effects of a constriction of the malt beverage supply are probably compensated for in part by increased yields from the state's liquor sales tax. As a consequence, these two taxes cannot be projected without consideration of the relation of the one to the other.

The experience with the state's liquor sales tax in the period, 1936-1942, before the introduction of state rationing, affords a very narrow base for projection. This factor, together with the indeterminate revenue effect of constriction of civilian malt beverage supplies, therefore, may cause the estimates of liquor sales tax revenues in normal postwar years and at the higher levels of income to be somewhat lower than will prove to be the case.

Corporate Net Income Tax

Corporate net income tax revenues in the postwar years cannot, at this time, be predicted from the Commonwealth's past experience with any degree of certainty. The reasons for this are the changes in the tax rate and tax base, effected by the General Assembly in 1943, the lack of data on actual tax yields for correlation with the unprecedented levels of state income since 1941, and consequently, the impossibility of determining the effects of federal wartime taxation on the state's earlier tax base, which had allowed such federal corporate taxes to be deducted from net income, taxable by the state. Furthermore, the limited and incomplete experience of one year under the amended corporate net income tax precludes the possibility of establishing the actual relation between the new tax base and its yields and the old tax base and yields in the taxable years, 1936 to 1942, inclusive.

In the following table three estimates of corporate net income tax yields, under the present law, have been made on the following assumptions:

(1) That the collections under the 4 percent tax will be approximately the same as they would have been under the 7 percent tax (this was assumed to be the case at the time of amendment of the corporate net income tax law);

(2) That the difference between actual 1943 collections and an estimate of such collections, plotted from a trend curve of the taxable years, 1936 to 1942, inclusive, amounting to $4.5 million, at a national income level of $138.1 billion, was due to the changes in the corporate net income tax base and rate and consequently, other amounts, resulting under assumption (1) can be adjusted proportionately;

(3) That New York State's experience (except for 1936 and 1938, years of exceptionally low corporate profits before taxes) is applicable to Pennsylvania, when the difference in the ratio of corporate net income tax collections to corporate net profits is taken into consideration. This assumption is made on the basis that the New York tax has never permitted deduction of federal corporate taxes from taxable net income and, furthermore, that the elimination of years of low corporate profits minimizes the effect of the alternative tax bases, which support a minimum revenue level under the New York tax law.

Based on these assumptions, the estimated revenues from a 4 percent tax under Pennsylvania's present corporate net income tax, at the selected levels of national income (payments—by states) would be as follows:

Level of National Income Payments—By States (in billions of dollars)	*Estimated Revenues under* *(1) above*	*(2) above*	*(3) above*
	(in millions of dollars)		
75	27.0	29.4	25.0
100	42.5	45.7	43.9
125	61.0	65.5	61.0
150	69.0	73.8	76.0

With full consideration of the factors, entering these three series, reasonable estimates of corporate net income tax collections at the four levels of national income would appear to be $27 million, $44.5 million, $63.0 million and $74.5 million, respectively. These rough estimates, or others of a similar character, appear to be the best available until further data, experience, and analyses of the tax base of the state's corporate net income tax have been accumulated over the course of several years.

Gross Receipts Tax (at Normal Rate)

The gross receipts tax collections, which are very comparable to actual yields for the years, 1936-1941, for which such a comparison can be made, show a surprisingly uniform distribution along a trend curve, relating collections to state income, excepting only 1936, when both the reported yield and collections were much higher than the experience in the later years. The trend curve shows a sharp increase between 1938 and 1941, when the range of state income was from $5 billion to $7.4 billion. Thereafter, the rate of increase decelerates over a range of state income from $7.4 billion (1941) to an estimated level of $10.3 billion in 1944.

Revenue collections, estimated for the selected levels of national income (payments by states), plotted from the trend curve of gross receipts tax collections are indicated as $3.2 million at the $75 billion level, $3.8 million at the $100 billion level, $4.1 million at a level of $125 billion, and $4.3 million at a level of $150 billion of national income.

The consistency of the relation of tax collections to state income for the gross receipts tax in the years 1937 to 1942, inclusive, is surprising in light of the Commonwealth's experience with this tax prior to this period. The available data indicate that a relatively large decrease in revenue from the present levels of this tax is likely to occur, only if state income should fall below $7.5 billion annually and national income below $100 billion.

Gross Premiums Tax

The trend curve of the collections from this tax, correlated to state income from 1936 to 1944 (estimated), shows almost a straight line increase between state income payments of $6.2 billion and an estimated state income of $10.8 billion. The greatest deviation from a trend curve occurs in the years 1940 and 1941. This apparent inconsistency is explained by a comparison of tax yields and tax collections for these two years. Collections in 1940 amounted to only $6.1 million, followed by $8.4 million in 1941, or an aggregate of $14.5 million. Actual yields for the two years amounted to the same total, but were distributed much more evenly between 1940 and 1941 in the amounts of $7.0 million and

$7.5 million, respectively. Tax yields and collections for other comparable years varied by only one-tenth of $1 million.

If the trend curve is adjusted by using 1940 and 1941 tax yields instead of collections for these years, the gross premiums tax, so established, shows nearly the same degree of consistency as the gross receipts tax. Estimated collections from the gross premiums tax, at the selected income payment levels of $75 billion, $100 billion, $125 billion, and $150 billion are $6.8 million, $7.4 million, $8.0 million, and $8.4 million, respectively.

Both the gross receipts and gross premiums tax revenues show a decidedly smaller degree of correlation with income at state income levels between $5 billion and $6 billion than is evident after national income (payments by states) has increased beyond $75 billion and Pennsylvania income payments beyond $6 billion.

Capital Stock and Franchise Tax

Revenues from this tax show the widest divergence from a plotted trend curve of any of the state's major taxes, which have bases directly or indirectly related to economic factors. This is due, in part, to the wide differences between tax yields and tax collections, which since 1936 have been as follows:

Year	*Yield* (in millions)	*Collections* (in millions)
1936	$36.6	$42.0
1937	30.2	29.5
1938	26.2	27.9
1939	28.0	27.8
1940	29.1	29.1
1941	29.6	34.6
1942	[a]	36.1
1943	[a]	34.4
1944	[a]	32.5[b]

[a] Not available.
[b] Estimated.

A trend curve, plotted on either capital stock tax collections or yields, fails to show any reasonable relation to 1943 and 1944 (estimated) revenues. Inasmuch as the course of collections is so irregular, it is doubtful whether any estimate drawn from this limited data has any greater value than as a check upon an estimate, made from observation of the behavior of this tax over a course of twenty years. Such an estimate places collections from this tax at the selected levels of income payments (by states) of $75 billion, $100 billion, $125 billion, and $150 billion at $29 million, $31 million, $33 million, and $35 million, respectively.

Other General Fund Taxes

The taxes on inheritance, transfers, and estates, and on shares and loans, as noted earlier, are of such a nature as to make methodical projection of these taxes useless. All three taxes, therefore, have been estimated at a conservative minimum yield, regardless of increases over the selected minimum level of $75 billion of national income.

The tax on documents and stock transfers and the corporate bonus are relatively small in magnitude and have, therefore, been estimated on a straight line projection, based on the Commonwealth's past experience with these taxes.

Other Revenue Sources

Other major revenue sources of the General Fund are institutional reimbursements, licenses and fees, penalties and interest on delinquent taxes, fines and penalties, and miscellaneous revenues.

Institutional reimbursements in the past have shown little correlation with state income payments and appear likely to remain fairly constant at approximately $6 million, under the present welfare system of the Commonwealth. It is likely that, if national income were to drop below the $75 billion level, there would be a slight decrease in institutional reimbursements, but experience to date shows no significant increase in these revenues, as the income level rises.

Revenues from licenses and fees, paid into the General Fund,[1] have shown a slight correlation with increases in state and national income payments. On the basis of available data and observation of these revenues over a number of years, it is estimated that an increase in national income from $75 billion to $150 billion would result in an increase from $4.2 million to $5.3 million. Experience indicates that the rate of increase is greatest between the income payment levels of $100 billion and $125 billion.

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[1] These do not include motor registrations and operators' licenses, which are deposited in the Motor License Fund.

Summary Comment on Projection Method

The above projection of General Fund revenues, in summary, results in the following estimates:

National Income (Payments—by states)	Pennsylvania Income	Estimated General Fund Revenues
(in billions of dollars)		(in millions of dollars)
75	6.1	162.0
100	7.7	195.0
125	9.2	227.4
150	10.8	251.2

On the whole, these estimates are based on the state's General Fund experience from 1936 to 1944 (estimated) and are conservative. The great number of factors, reviewed in the earlier pages, which enter into a projection made at this time, makes the results highly tentative, so that they should be considered as a guide rather than a definite prediction.

Particularly difficult problems attend the projection of four of the state's major taxes. These are the projection from completely inadequate basic data of the four percent corporate net income tax on its new base; the effect of the return to civilian life of nearly one-tenth of the nation's population, and the consequent result on specific consumption tax revenues; the erratic trends of the capital stock tax, especially at the higher levels of income; and, finally, the uncertainties attending the receipt of liquor store profits, which are not a direct revenue of the General Fund, but are transferred from the State Stores Fund, the operating fund of the State Stores System.

The method of projection also discounts the possibilities of an acceleration of many unfavorable trends in the Commonwealth's economy, which may result in less favorable revenue results, even at higher levels of national income than was the case in the pre-war years. Such considerations, dependent upon postwar problems and the Commonwealth's economy, can be weighed in accordance with each individual's knowledge or opinion to increase or decrease the estimated revenues in total or by item. For this reason, the estimates, herein presented, have been made with the minimum departure possible from recorded data and accepted methods of projection.

1. CORPORATE NET INCOME TAX

2. CAPITAL STOCK AND FRANCHISE TAXES

Year	1. National Income Payments Total By States	Pennsylvania	2. Corporate Net Income Yield [1]	Collections [2]	Capital Stock and Franchise Taxes Yield [1]	Collections [2]
	(in billions of dollars)		(in millions of dollars)		(in millions of dollars)	
1936	68.0	5.8	34.1[3]	29.8[3]	36.6	42.0[4]
1937	72.3	6.2	27.9	28.1	30.2	29.5
1938	66.1	5.4	15.5	16.3	26.2	27.9
1939	70.7	5.8	23.0	23.6	28.0	27.8
1940	75.8	6.2	28.8	29.6[5]	29.1	29.1
1941	92.2	7.4	41.6	39.9[5]	29.6	34.6
1942	114.7	8.7	....	50.7[5]	....	36.1
1943	138.1	9.9	....	66.3[6]	....	34.4
1944	142.5[7]	10.3[7]	....	62.9[7]	....	32.5[7]

Ratios

Year	Total By States	Pennsylvania	Yield	Collections	Yield	Collections
1936	94	94	85	....	121	....
1937	100	100	100	100	100	100
1938	91	87	55	58	86	94
1939	98	94	82	83	92	94
1940	104	99	103	105	96	98
1941	128	119	149	141	98	117
1942	159	140	....	180	....	122
1943	191	159	....	235	....	116
1944	197	166	....	223	....	110

[1] Yield year = calendar year, in which tax is based on fiscal year of corporations ending in that calendar year.

[2] Collection year = fiscal year of the Commonwealth, in which most of the taxes are collected.

Example: taxes for calendar year 1936, collected on March 15 and April 15, 1937, are in the 1936-1937 fiscal year.

[3] At 10 percent rate in 1936; 7 percent rate, but same tax base, from 1937 to 1942, inclusive.

[4] Part of two years' collections—self-assessment began in fiscal year 1936-1937.

[5] Federal excess profits taxes, as well as federal corporate net income tax, deducted from corporate net income for state tax purposes in these years.

[6] Method of assessment changed—federal taxes eliminated as deduction.

[7] Estimated.

3. SHARES TAXES

4. LOANS TAXES

Year	*National Income Payments* *Total By States*	*Pennsylvania*	*3. Shares Tax* *Yield*	*Collections*	*4. Loans Tax* *Yield*	*Collections*
	(in billions of dollars)		(in millions of dollars)		(in millions of dollars)	
1936	68.0	5.8	4.3	2.5	6.2	12.2
1937	72.3	6.2	3.2	5.3	6.0	7.1
1938	66.1	5.4	3.5	3.2	5.6	4.7
1939	70.7	5.8	3.4	3.4	5.0	7.2
1940	75.8	6.2	4.0	3.5	4.7	4.9
1941	92.2	7.4	3.5	3.7	4.8	5.0
1942	114.7	8.7	...	3.6	...	4.4
1943	138.1	9.9	...	3.5	...	4.4
1944 [1]	142.5	10.3	...	3.7	...	4.6

Ratios

1936	94	94	134	78	103	171
1937	100	100	100	165	100	100
1938	91	87	109	100	93	66
1939	98	94	106	106	83	101
1940	104	99	125	109	78	69
1941	128	119	109	115	80	70
1942	159	140	...	112	...	61
1943	191	159	...	109	...	61
1944	197	166	...	115	...	64

[1] Estimated.

5. MALT BEVERAGE
6. LIQUOR TAX
7. LIQUOR PROFITS

Year [2]	National Income Payments Total By States	Pennsylvania	5. Malt Beverage Tax	6. Liquor Tax	7. Liquor Store Profits
	(in billions of dollars)		(in millions of dollars)		
1936	68.0	5.8	7.4	7.2	23.0
1937	72.3	6.2	7.4	7.8	15.0
1938	66.1	5.4	6.8	7.3	17.0
1939	70.7	5.8	7.1	7.0	16.0
1940	75.8	6.2	7.1	8.6	18.0
1941	92.2	7.4	8.6	10.5	18.0
1942	114.7	8.7	8.6	13.7	23.0
1943	138.1	9.9	10.5	10.1	13.5
1944 [1]	142.5	10.3	10.5	11.5	20.5

[1] Estimated.

Ratios

1936	94	94	100	92	153
1937	100	100	100	100	100
1938	91	87	91	93	113
1939	98	94	95	89	106
1940	104	99	95	110	120
1941	128	119	116	134	120
1942	159	140	116	175	153
1943	191	159	141	129	90
1944 [1]	197	166	141	147	136

[1] Estimated.

[2] Calendar year containing the greatest proportion of the Commonwealth's fiscal year—Commonwealth's fiscal year 1936-1937 is used for calendar year 1936, since it has eight months of 1936 taxes and four months of 1937 taxes.

8. CIGARETTES

9. LIQUID FUELS

5 and 6. MALT BEVERAGE AND LIQUOR TAXES COMBINED

Year	*National Income Payments* *Total By States*	*Pennsylvania*	*8. Cigarette Tax*	*9. Liquid Fuels Tax*	*5 and 6. Malt Beverage and Liquor Tax*
	(in billions of dollars)		(in millions of dollars)		
1936	68.0	5.6	10.8	13.1	14.6
1937	72.3	6.2	11.2	13.8	15.2
1938	66.1	5.4	11.1	13.9	14.1
1939	70.7	5.8	11.9	14.2	14.1
1940	75.8	6.2	12.4	16.5	15.7
1941	92.2	7.4	13.7	16.6	19.1
1942	114.7	8.7	13.7	11.4	22.3
1943	138.1	9.9	14.6	11.0	20.6
1944[1]	142.5	10.3	15.0	11.5	22.0

Ratios

1936	94	94	96	94	96
1937	100	100	100	100	100
1938	91	87	99	101	92
1939	98	94	106	102	92
1940	104	99	110	119	103
1941	128	119	122	120	125
1942	159	140	122	82	146
1943	191	159	130	79	134
1944[1]	197	166	133	83	144

[1] Estimated.

10. GROSS RECEIPTS

11. GROSS PREMIUMS

Year	National Income Payments Total By States	National Income Payments Pennsylvania	10. Gross Receipts Yield	10. Gross Receipts Collections	11. Gross Premiums Yield	11. Gross Premiums Collections
	(in billions of dollars)		(in millions of dollars)		(in millions of dollars)	
1936	68.0	5.8	3.9	3.8	6.3	6.4
1937	72.3	6.2	3.2	3.3	6.7	6.8
1938	66.1	5.4	2.7	2.7	6.8	6.9
1939	70.7	5.8	3.1	3.1	6.8	6.7
1940	75.8	6.2	3.4	3.3	7.0	6.1
1941	92.2	7.4	3.7	3.8	7.5	8.4
1942	114.7	8.7	...	3.9	...	7.6
1943	138.1	9.9	...	4.1	...	8.1
1944 [1]	142.5	10.3	...	4.2	...	8.3
Ratios						
1936	94	94	122	115	94	94
1937	100	100	100	100	100	100
1938	91	87	84	82	101	101
1939	98	94	97	94	101	99
1940	104	99	106	100	104	90
1941	128	119	116	115	112	124
1942	159	140	...	118	...	112
1943	191	159	...	124	...	119
1944 [1]	197	166	...	127	...	122

[1] Estimated.