REPORT

of

FINDINGS AND RECOMMENDATIONS

on the

PENNSYLVANIA TAX SYSTEM

by the

TAX STUDY COMMITTEE

Under Authority of

Act of Assembly

Approved July 9, 1947

(P. L. 1468)

PART II

FEBRUARY 1949

ACT OF ASSEMBLY CREATING TAX STUDY COMMITTEE AND DIRECTING ITS INVESTIGATION OF PENNSYLVANIA TAX STRUCTURE

Authorizing the Joint State Government Commission to make a thorough study of the tax laws of the Commonwealth and of other states and countries in order to ascertain ways and means of financing the Commonwealth and its political subdivisions upon a more scientific and equitable basis; providing for the appointment of a tax study committee; authorizing the employment of necessary assistants; prescribing the powers and duties of the committee; and making an appropriation.

Whereas, the existing tax structure of the Commonwealth has been developed on a piecemeal basis with the result that it lacks a scientific and equitable basis,

Whereas, it is frequently represented that our present tax structure unduly burdens industrial enterprise, with the result that new industrial enterprises are deterred from locating in the Commonwealth, and existing industrial enterprises are in an unfavorable competitive position, and

Whereas, increasing demands for government service result in the necessity of raising additional revenue to pay the cost thereof which must not be levied so as to destroy the industrial position of the Commonwealth.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. A committee to be known as the Tax Study Committee is hereby authorized under the Joint State Government Commission, consisting of the Secretary of Commerce, ex officio, who shall be chairman thereof, and six other members, two of whom are to be appointed by the Governor, two by the President pro tempore of the Senate, and two by the Speaker of the House of Representatives to study the laws of this Commonwealth and of other states and countries relating to taxation; to investigate systems and methods of taxation in order to provide ways and means of financing the Commonwealth and its political subdivisions upon a more scientific and equitable basis and to safeguard and enhance the industrial position of the Commonwealth. The members of the Committee shall serve without compensation, but they shall be reimbursed for their living and traveling expenses necessarily incurred in the performance of their duties.

Section 2. The Committee is hereby authorized to sit at Harrisburg, or elsewhere, within the Commonwealth and to employ a secretary and counsel and such other assistants as may be necessary.

Section 3. Vacancies occurring in the membership shall be filled by appointment by the authority who appointed the members whose place is vacated.

Section 4. The Tax Study Committee shall report its findings and recommendations to the Joint State Government Commission and the Commission on or before February one, one thousand nine hundred and forty-nine shall report the results of its investigation to the Governor and the General Assembly, together with such proposed legislative measures as it deems advisable to carry its recommendations into effect.

Section 5. The sum of one hundred thousand dollars ($100,000), or as much thereof as may be necessary, is hereby appropriated to the Commission for the purpose of paying the expenses of the members of said Tax Study Committee and the salaries and traveling expenses of its employees for the preparation, editing, printing and distribution of the report of the Commission and any other expenses necessary to be paid on warrants of the Auditor General in favor of the chairman of the Commission, on presentation of his requisition for the same, for the work of the Commission in connection with said tax study.

APPROVED—The 9th day of July, A. D. 1947, in the sum of $50,000. I withhold my approval from the remainder of said appropriation because of insufficient State revenue.

JAMES H. DUFF.

The foregoing is a true and correct copy of Act of the General Assembly No. 562.

C. M. Morrison,
Secretary of the Commonwealth.

LETTER OF TRANSMITTAL

To his Excellency, the Honorable James H. Duff, Governor of Pennsylvania, and the Honorable the General Assembly of the Commonwealth of Pennsylvania:

The Joint State Government Commission transmits herewith Part II of a report of the findings and recommendations of the Tax Study Committee, on the Pennsylvania Tax System, in accordance with the provisions of Act No. 562, Session of 1947, Section 4, which requires that the Commission shall file the report of the Tax Study Committee with the Governor and the General Assembly on or before February 1, 1949.

WELDON B. HEYBURN, *Chairman.*

Joint State Government Commission
Capitol Building
Harrisburg, Pennsylvania
February 1949

TAX STUDY COMMITTEE

ORUS J. MATTHEWS, *Chairman*
JAMES A. GELTZ, *Vice Chairman*

APPOINTEES OF THE GOVERNOR:

FRANK WILBUR MAIN
PHILIP STERLING, ESQUIRE

APPOINTEES OF THE PRESIDENT PRO TEMPORE OF THE SENATE:

JAMES A. GELTZ
LLOYD H. WOOD

APPOINTEES OF THE SPEAKER OF THE HOUSE OF REPRESENTATIVES:

LAMBERT CADWALADER
WARNER M. DEPUY

MEMBER BY STATUTE:

ORUS J. MATTHEWS

LETTER OF TRANSMITTAL

To the Joint State Government Commission:

In accordance with Act No. 562, Session of 1947, Section 4, the Tax Study Committee transmits herewith Part II of a report of its findings and recommendations on the Pennsylvania Tax System for submission to His Excellency, the Honorable James H. Duff, Governor of Pennsylvania, and the Honorable the General Assembly of the Commonwealth of Pennsylvania.

Part I, previously submitted, reviewed state business taxes, the county personal property tax, which is related to existing corporate taxes, and "emergency" taxes and emergency tax rates. Part II, which completes the report of the Tax Study Committee's findings and recommendations, surveys the area of state-local fiscal relations.

ORUS J. MATTHEWS, *Chairman.*

Tax Study Committee
Harrisburg Pennsylvania
December 1948

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PRECEPTS, FACTS AND RECOMMENDATIONS

The General Assembly of 1947 directed the Tax Study Committee to recommend to the General Assembly of 1949 "ways and means of financing the Commonwealth and its political subdivisions upon a more scientific and equitable basis and to safeguard and enhance the industrial position of the Commonwealth."

Part I of the Committee's report presents tax measures calculated to assure the financing of the Commonwealth in conformity with the legislative mandate. Part II deals with the financing of the Commonwealth's political subdivisions, exclusive of local highway financing because Act No. 12-A, Session of 1947, amending the Act of May 29, 1945, assigned the subject to another committee.

The Tax Study Committee's recommendations relating to the financing of the political subdivisions are based upon the following broad precepts, facts and considerations:

1. If the industrial position of the Commonwealth is to be safeguarded and enhanced, local taxing powers must be so defined as to give reasonable assurance that effectiveness of productive processes will not be impaired thereby.

2. Continued reliance upon real property taxation as the principal source of local revenue is no longer practical and equitable; increasing resistence to the taxation of real property has developed in large measure by virtue of the inadequate and inequitable assessment practices. Even should these practices be completely corrected, real property, as an object of local taxation will not, within sound economic lim-

itations, produce adequate revenues necessary to meet the present minimum needs of local government.

Faced with the need for additional local revenues, and cognizant of the fact that the taxation of real estate has reached the limit, the General Assembly of 1947 passed Act No. 481. However, it is the judgment of the Committee that this act violates the principle outlined in 1, above.

To assure adequate revenues for the political subdivisions under conditions that will safeguard and enhance the industrial position of the Commonwealth, the Committee recommends the following modifications in the prevailing fiscal relations between the Commonwealth and its political subdivisions.

I. MODIFICATION AND CLARIFICATION OF THE POWERS OF SELECTED MUNICIPALITIES TO LEVY TAXES

The Committee recommends:

A. That *all* school districts be restricted, by means of general statutes, to the imposition of real estate and per capita taxes. This will entail that the General Assembly of 1949 not reenact P. L. 733 and P. L. 745, Session of 1947, which authorize the school districts of Philadelphia and Pittsburgh, respectively, to levy personal property taxes at the maximum rate of four mills and mercantile license taxes at the rate of ½ mill wholesale and 1 mill retail. It will entail also that the General Assembly of 1949 not reenact P. L. 728, Session of 1947, which authorizes the school district of Pittsburgh to levy a per capita tax at the maximum rate of $5 for "the fiscal year beginning January first, one thousand nine hundred and forty-eight."

B. That Act No. 481, Session of 1947, be amended to allow permissive taxation, restricted to residents, at only one level of local government—cities, towns, first class townships and boroughs—permissive taxes to be restricted to the following:

1. Wage and salary taxes
2. Per capita taxes
3. Taxes upon the income derived from unincorporated business and professional activity, provided the General Assembly of 1949 does not elect to tax such income at the state level.

C. The Committee suggests that the General Assembly specify the maximum rates at which the taxes enumerated under B, above, may be imposed.

II. THE FINANCING OF STATE-MANDATED LOCAL FUNCTIONS

The Committee recommends that Commonwealth-mandated increases in local governmental costs be financed by means of a broad-based, Commonwealth-imposed tax, properly allocated among the political subdivisions.

At present, Article IX of the Constitution of Pennsylvania makes it impossible for the Commonwealth to levy personal income taxes which provide for personal exemptions and graduated rates.

The Committee recommends that the General Assembly take under advisement appropriate amendment to Article IX.

The Committee recommends the imposition of a retail sales and use tax, upon tangible personal property, except food sold for off-premise consumption and commodities now subject to Commonwealth excise taxes, at a rate not to exceed

2%. It is the purpose of this proposed tax to facilitate the financing of Commonwealth-mandated local governmental costs and to compensate for the loss, actual and potential, to political subdivisions occasioned by the limitations recommended by the Committee and outlined under I, above.[1]

The Committee further recomends that 75% of the proceeds of this tax be distributed among the school districts in such manner as to assure the financing of Commonwealth-mandated school costs at local tax rates not to exceed 6 mills upon the valuation of locally taxable real estate; the remaining 25% to be distributed on a population basis among all political subdivisions other than school districts and counties.

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[1] The imposition of a retail sales and use tax would establish in Pennsylvania a broad base tax which might be used to finance other contingencies, such as the soldiers' bonus.

SECTION I

PERMISSIVE LOCAL TAXATION

Under Authority of Act No. 481 (P. L. 1145, June 25, 1947)

Since the end of World War II, the major fiscal problem confronting state and local governments throughout the country has been the inadequacy of local government revenue to meet the increasing demand for services at increased costs. Most state governments have been able to enjoy more or less automatic increases in tax revenue resulting from higher levels of economic activity. This has not been true of local governments because of their heavy dependence, in Pennsylvania and elsewhere, upon real property taxes.

There are several reasons why the real property tax in Pennsylvania has become an increasingly unsatisfactory and inadequate source of local revenue.

(1) There has been a wide variation of assessment practices resulting in inequitable assessment of many classes of property.

(2) There is considerable evidence to indicate that assessed valuations have tended to lag behind market values.

(3) There has been a gradual increase in the proportion of tax exempt real property.

Faced with the need for additional local revenues, and cognizant of the fact that the taxation of real property has reached the limit, the General Assembly of 1947 enacted legislation authorizing permissive local taxation.

Act No. 481 (P. L. 1145, June 25, 1947) authorizes certain political subdivisions of the state to levy taxes on any and all subjects not taxed by the Commonwealth. The political subdivisions included within the scope of the act are the 2nd, 2nd A and 3rd class cities, boroughs, towns, first class townships and school districts of the 2nd, 3rd and 4th class. All counties and second class townships are outside the scope of the act, as are the City of Philadelphia and the school districts of Philadelphia and Pittsburgh. Supplemental local taxing powers were authorized for Philadelphia under legislation passed in 1932 and for the school districts of Philadelphia and Pittsburgh by legislation in 1947.

Of the state's 5,173 political subdivisions, 3,588 were granted additional taxing authority. Act 481 prohibits the levy of taxes on gross receipts from utility service companies subject to regulation by the Pennsylvania Public Utility Commission and provides that the total amount of additional taxes levied cannot exceed the maximum permissible yield on real estate subject to taxation within the jurisdiction.

Table 1 shows the political subdivisions authorized to levy taxes under Act No. 481 and the number of such subdivisions which have adopted new levies as of December 1, 1948. In the short period since the enactment of Act No. 481, about 20 per cent of the political subdivisions authorized to impose such new taxes have done so. Third class cities have used the taxing powers most extensively; about 16 per cent of the boroughs and somewhat less than 20 per cent of the school districts have adopted such new taxes as of this date.

Table 2 shows the type of permissive taxes which have been enacted as of December 1, 1948, classified according to political subdivisions. Per capita taxes have had widespread adoption; severance taxes on coal and other natural resources and amusement or admissions taxes are being utilized extensively. Examination of the taxes so levied as reported to the Department of Internal Affairs reveals that most political subdivisions have levied one additional tax, although about one-fifth of those reporting have imposed two taxes and one school district has imposed six new taxes. A wide range of tax rates is established by the levies; no "typical" rate seems to predominate.

It is hazardous to estimate the revenue importance of the levies imposed under authorization of Act No. 481. Few of the political subdivisions have filed yield estimates with the Department of Internal Affairs, and in any event, operating experience has been too limited in most instances to permit accurate determination of probable revenues. However, external evidence suggests that yields have been adequate to hold down the level of real estate taxes in many political subdivisions.

A review of the operations of Act No. 481 reveals a number of unfortunate consequences. The first of these is the problem resulting from the overlapping territorial boundaries. Act No. 481 gives tax preference to the political subdivisions of the taxpayer's residence by providing that the taxpayer can deduct from similar tax liabilities imposed elsewhere, the taxes paid to the political subdivision wherein he resides. Under a recent decision (Lackawanna County Common Pleas No. 11, September Term, 1948) coterminous municipalities and school districts may levy the same tax. These provisions have complicated employer compliance by requiring the employer to withhold and return to a number of jurisdictions the taxes due on wage and salary disbursements. Disputes between local governments over priority to the right to tax and overlapping of tax jurisdictions have met with some public disapproval. There is ample justification for the enactment of amendments which at least will limit permissive taxation to one level of government.

The variety and complexity of some of the taxes which have been enacted has provoked just criticism of Act No. 481. A few political subdivisions have imposed an employer's tax at rates ranging from $3 to $15 for each employee. Several units have imposed stamp taxes on real estate conveyances and deeds, generally at a 1 per cent rate. Another political subdivision has levied a tax of 7c per ton on the loading of ashes and cinders. Severance taxes have been levied at rates ranging from 1c to 10c per ton of coal.

The local revenue structure of Pennsylvania has been complicated by new taxes. Local political subdivisions have created many new collection mechanisms, some of doubtful efficiency. Taxpayer cost of compliance with local taxing laws has increased and taxpayers face considerable uncertainty as to the type and rate of tax which may be imposed at any time by local governments.

When evaluating the experience under Act No. 481, it should be noted that, thus far, the taxes levied pursuant to the authority of this act have been imposed under conditions of exceedingly high employment and income levels. Even now levies have been enacted which place certain business enterprises at economic disadvantage. Without restrictive amendments, the situation may be expected to become more serious. Under less favorable economic conditions, the present authority of permissive taxation may well be used to establish "protected" economic areas which restrict the free flow of goods within the Commonwealth.

Act No. 481 should be amended to eliminate the objectionable consequences of its operation, and to prohibit the levying of taxes which may impair the productive processes of the Commonwealth. The principle of permissive local taxation should be retained in Pennsylvania, but its application limited to specified taxes at specified maximum rates. Permissive taxation should be made available to only one level of government, namely cities, towns, boroughs and first class townships. The authority of these municipalities to tax non-residents employed within their jurisdiction should be removed. These amendments would eliminate the imposition of taxes on the same taxable by more than one political subdivision, simplify the tax structures, and reduce taxpayer uncertainties.

The Tax Study Committee recommends that cities, towns, boroughs and first class townships should be given authority to levy at specified maximum rates taxes on wages and salaries, per capita taxes and taxes on the net income of unincorporated business and professional activity, the latter, however, only in the event that the Commonwealth does not impose a state tax on this base.[1] This, together with the enactment of a Commonwealth tax on investment income, as recommended in Part I, would broaden the Pennsylvania tax base to include all types of income: corporate and investment income, taxable at the state level; wages and salary income, taxable at the local level; unincorporated business and professional income, taxable at either the state or local level.

The proposed amendments to Act No. 481 should make a substantial contribution to the adequate and rational financing of local governments in Pennsylvania.

The Committee recommends that all school districts be restricted, by means of general statutes, to the imposition of real estate and per capita taxes. This may be accomplished by limiting the use of permissive taxes to cities, towns, bor-

[1] For present wage and salary tax rates and per capita tax rates see Tables 3 and 4.

oughs and first class townships, and *by not* reenacting P. L. 733 and P. L. 745, Session of 1947, which authorize the school districts of Philadelphia and Pittsburgh to levy personal property taxes at the maximum rate of 4 mills and mercantile taxes at the rate of ½ mill wholesale and 1 mill retail. It will also be necessary that the General Assembly *not* reenact P. L. 728, Session of 1947, which authorizes the school district of Pittsburgh to levy a per capita tax at the maximum rate of $5 for "the fiscal year beginning January first, one thousand nine hundred and forty-eight."

SECTION II

FINANCING OF STATE-MANDATED LOCAL FUNCTIONS

The use of permissive taxing authority under Act No. 481 by almost 20 per cent of Pennsylvania school districts is a rough measure of the revenue needs faced by these districts. The Commonwealth can assist school districts, through grants-in-aid, with revenues derived from Commonwealth-imposed taxes.

At the present time Article IX of the Constitution prohibits the levy of personal income taxes with exemptions and graduated rates. This is a limitation of the state's taxing powers, and may be removed by appropriate amendment.

The Committee recommends the imposition of a retail sales and use tax on tangible personal property, except food sold for off-premise consumption, and commodities now subject to Commonwealth excise taxes, at a rate not to exceed two per cent. The taxation of retail sales at the rate of two per cent would make available to the Commonwealth additional revenue of approximately $90 million annually, at 1948 levels of economic activity.

The additional revenue produced by a sales tax at a rate of 2 per cent would permit the Commonwealth to facilitate the financing of state-mandated local school costs, and compensate for the loss to political subdivisions, actual and potential, resulting from the proposed amendments to Act No. 481. The Committee recommends that 75 per cent of the yield from the sales tax, which, at rate of 2 per cent, would amount to an estimated $67.5 million, be distributed among school districts in such a manner as to assure the financing of Commonwealth-mandated schools costs at school district tax rates not to exceed 6 mills on the assessed valuation of locally taxable real estate. The remaining 25 per cent of the yield from the sales tax at a 2 per cent rate—estimated at $22.5 million at 1948 levels of economic activity—should be distributed on the basis of population among all political subdivisions other than school districts and counties. This will provide estimated additional revenue of $2.14 per capita for all cities, boroughs, towns and townships.

The adoption of the Tax Study Committee's recommended revisions in the pattern of state-local finance in Pennsylvania will greatly simplify tax administration for the Commonwealth and its political subdivisions.

TABLE 1

Pennsylvania Political Subdivisions Authorized to Levy Taxes Under Act No. 481 and Number Imposing Permissive Taxes, December 1, 1948

Type of Political Subdivision	*Number in State*	*Number Imposing Permissive Taxes*
(1)	(2)	(3)
Cities, Class 2	1	1
Cities, Class 2A	1	1
Cities, Class 3	46	34
Boroughs	934	148
Townships, Class I	61	16
Town	1	1
School Districts	2,544	477
Total	3,588	678
Political Subdivisions excluded from Act No. 481	1,585	
Total Pennsylvania Political subdivisions	5,173	

SOURCE: Department of Internal Affairs.

TABLE 4

Rates of Per Capita Taxes Imposed Under Authority of Act No. 481, as of December 1, 1948

Type of Political Subdivision	*Total Number of Political Subdivisions Levying Wage Taxes*	*Per Capita Tax Rates*							
		$1.00 $1.50 $2.00	$2.50 $3.00 $3.50	$4.00 $5.00 $6.00	$7.00 $7.50 $8.00	$10.00 $12.00 $15.00	$20.00	$5 Male $3 Female	$1 Male $2 Female
		Number of Political Subdivisions Levying Per Capita Taxes at Rates Indicated Above							
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Cities, 3rd Class	3	..	..	3	..	..	..	..	..
Boroughs	30	4	8	16	..	..	..	1	1
Townships, 1st Class	2	..	1	1	..	..	..	..	..
School Districts, 2nd Class	..	..	..	..	..	..	..	..	..
School Districts, 3rd Class	36	3	13	14	2	4	..	..	..
School Districts, 4th Class	154	18	29	78	9	19	1	..	..
Total	225	25	51	112	11	23	1	1	1

SOURCE: Department of Internal Affairs.