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Speakers Committee on Tax Reform 1970

THE SPEAKER'S COMMITTEE ON TAX REFORM

PENNSYLVANIA HOUSE OF REPRESENTATIVES

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HOUSE OF REPRESENTATIVES
COMMONWEALTH OF PENNSYLVANIA
HARRISBURG

November 27, 1970

THE SPEAKER'S COMMITTEE ON TAX REFORM
Pennsylvania House of Representatives

Dear Fellow Member of the House:

There is transmitted herewith the report of the Speaker's Committee on Tax Reform which was established on March 7, 1970.

The purpose of such committee was to conduct within the limited time available to it, a comprehensive study of the entire State and local tax structure of the Commonwealth of Pennsylvania and present to the House of Representatives recommendations which would not only constitute tax reform, but would, if enacted into law, provide a more sound, progressive and equitable State and local tax structure for our Commonwealth.

The committee desires to make it clear that its function was not to examine present or future budgetary requirements for any level of government. And while the committee, wherever possible, did examine the revenue estimates involving various tax measure revisions or additions, it did so mainly for the purpose of evaluating the State and local tax impact which might occur as a result of formulating broad tax reform guidelines and not to present a balanced expenditure-revenue budget for the fiscal year. The enactment of a balanced operating budget for such year is a matter solely within the purview of the Administration and General Assembly.

No tax study committee can properly function without the aid of staff who are experts in the complex field of State and local taxation. Therefore, the committee gratefully acknowledges the wealth of tax information and advice given it by staff who sat with the committee throughout its meetings, with a special commendation to Dr. Paul Bruton for his expert advice and knowledge in the income tax field.

The committee also expresses its special appreciation to Mr. John W. Ingram, Director, State Division; Mr. Robert S. Lewis, Assistant Director, State Division; and Charles G. Passmore, Senior Research Analyst; all from the Pennsylvania Economy League, Inc., who continuously sat with the committee and presented to it vital tax information and in-depth research assistance. The committee also is grateful to the Pennsylvania Economy League for its kind cooperation and consideration in making available the research talents of such men.

Respectfully,

The Speaker's Committee on Tax Reform

Herbert Fineman, Chairman

SUMMARY OF RECOMMENDATIONS

	Revenue Gains (Millions) Loss (Per 1%)
I. SALES AND USE TAX	
1. TAX RELIEF PROVISIONS	
A. The general tax rate be reduced from 6% to 4%, and that the tax base be broadened in order to offset all or part of the revenue loss resulting from this reduction.	-166.0
B. Restaurant meals under 26¢ be exempt from tax.	- 1.3
2. TAX ADDITIONS AND REFORM PROVISIONS	
A. All of the production exemptions be eliminated.	15.0
B. The Committee recommends elimination of the following exemptions and exclusions:	
1. The exclusion for delivery, installation or application charges when separately stated.	6.2
2. Elimination of the trade-in allowance.	1/
3. Elimination of the "demonstrator" exemption.	1/
4. Elimination of the "isolated transaction" exemption.	1/
5. Elimination of the braodcasting and television exemptions.	1/
6. Elimination of the ship repair exemption, and so much of the ship's stores and supplies exemption as applied to the purchase of such property for the equipping of a new ship.	1/
7. Elimination of the exemption for mail order catalogues and direct mail advertising materials.	1/
8. Elimination of the exemption for rail transportation equipment.	1/
9. Elimination of the fee fishing exemption.	1/
10. Elimination of the exemption on magazines and periodicals except newspapers.	1.8
11. Elimination of the exemption on restaurant meals sold by hospitals.	1/
12. Elimination of the alternate imposition provisions.	1/
13. Elimination of the interstate commerce exemptions of Section 2 (n) and 2 (h) of the Act, except insofar as said exemptions are mandated by the Federal Constitution.	1/

1/ No reliable estimates were immediately available for the noted recommendations above; however the Committee believes that if the Legislature will adopt these recommendations, the over-all gain in revenues per 1% rate will be substantial and will offset part, if not all, of the revenue loss occurring as a result of reducing the sales tax rate.

	Revenue Gains (Millions) Loss (Per 1%)
C. The following recommendations for other changes in the Act were agreed to:	
1. The tax on alcoholic beverages shall be computed upon a retail basis, rather than upon the wholesale price.	2.6
2. The tax shall be imposed upon candy, chewing gum, and similar confections;	1.6
3. Specific language be added to the Act authorizing the Commonwealth to enter into compacts with other states for the collection of sales and use taxes of those states on a reciprocal basis.	
4. The tax be imposed upon charges for moving household goods and furnishings and business equipment and supplies in the process of relocation from one permanent location to another.	2/
5. The use tax reporting and collection provisions be strengthened in the following manner:	3/

a. A provision be added that the resale exemption is merely presumptive unless and until the person claiming the exemption reports the actual resale to the Department of Revenue.

b. Evasion of the use tax should be punishable by more stringent criminal and civil penalties and more use of the bonding provisions of the Act should be made.

c. The "arms length transaction" provisions of the Act be amended to establish a presumption with respect to subsidiary or controlled corporations which sell to affiliates or parents.

II. PERSONAL INCOME TAX

	Revenue Gain Per 1%
A. The Committee recommends that there be enacted a personal income tax to be levied at a uniform rate upon taxable income as defined for federal tax purposes.	$233.7 million

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2/ See Note 1/, Page "A".

3/ Although the immediate revenue effect of these improved reporting and collection methods cannot be ascertained with certainty, it is felt that their adoption will substantially increase revenues.

1. A single comprehensive act should incorporate the provisions necessary to deal consistently with partnerships, estates, trusts, beneficiaries and decedents, as well as individuals.
2. The tax be imposed at a uniform rate upon taxable income as defined for federal tax purposes.
3. That a vanishing tax credit be allowed against the State income tax liability in order to offset the regressivity of a flat tax rate on low and moderate income families. (described in report)
4. That a Constitutional amendment be adopted to remove the present restriction upon an income tax with graduated rates, so that future Legislatures may adopt such a tax if they see fit to do so.

III. LOCAL GOVERNMENT TAXATION

A. That the Local Tax Enabling Act be amended to the end that the income base of all local income taxes corresponds to the income base of the state income tax.

B. The school districts, other than Philadelphia and Pittsburgh, be authorized to levy income taxes (on the state base) without limit as to rate, but applicable only to residents of the district.

C. That all municipalities (but not counties) except for the City of Philadelphia, be authorized to levy an income tax (on the state tax base) without limit as to rate on all the earned and unearned income of persons residing within the municipality, but subject to rate limitation on income earned within the municipality by non-residents. A taxpayer would be credited, against tax liability in his municipality of residence with the tax paid on his earned income in his municipality of employment.

D. That municipal and school district income taxes be collected by the Commonwealth, together with the state income tax, and allocated to the taxing jurisdictions to which they are due.

E. That the following taxes be abolished:

1. The occupation tax
2. The occupational privilege tax
3. The per capita tax
4. The Mercantile Tax

F. That the personal property tax as levied by counties and by the City of Pittsburgh be abolished. (This recommendation does not include the Pittsburgh school district which has special taxing authority.)

G. That the real estate transfer tax be allocated entirely to county governments.

H. That the taxing authority of the City of Philadelphia remain as now set forth in the law, subject to the following modifications:

1. That the City allow a credit against its earned income tax equal to 50% of the tax paid by a city resident to another municipality where employed.
2. That the City allow a credit against its earned income tax equal to 50% of the tax paid by a non-resident worker to his or her municipality of residence.
3. That the Commonwealth, from the proceeds of the recommended state income tax, reimburse the City for the tax revenue lost due to the above credits.

I. That the implementation date for these recommendations be established in the law as the beginning of a fiscal year for each class of local government at least one year following the effective date for collection of the proposed state income tax.

IV. BUSINESS TAXES

		Revenue Gain or Loss
A.	The Corporate Net Income Tax rate should be reduced from 12% to 10%, provided that the present tax base is expanded in order to offset at least part, if not all, of the general fund revenue loss occurring as a result of such reduction.	-43.0 (per 1%)
B.	The destination point concept should be used in lieu of the office concept as a basis for the allocation of gross receipts in both the Corporate Net Income and Franchise taxes.	5.0
C.	If the Uniform Act is not enacted, the wages and salaries fraction of the apportionment formula for the Corporate Net Income Tax and the Franchise Tax should be amended to eliminate the language "connected with".	
D.	The statutory language permitting a corporation to allocate should be reformed to make it uniform and limit allocation to the Federal Constitution requirement.	4/
E.	The dividends received deduction available to corporations under the Corporate Net Income Tax should be changed to conform to the federal tax treatment of dividends.	
F.	The Corporate Net Income Tax should be amended to make a corporation liable for gains realized from the sale of property after the corporation has ceased to do business within the Commonwealth.	

4/ No reliable revenue estimate available, but it is believed that this reform will produce a material increase in revenues.

		Revenue Gain or Loss
G.	The Capital Stock Tax Act should be amended to prevent real estate companies from utilizing the manufacturing exemption when the lessor company did not operate the manufacturing plant.	
H.	The Domestic and Foreign Excise Taxes should be repealed.	-8.0
I.	The Corporate Loans Tax should be repealed.	-2.9
J.	The taxation of commercial banks and mutual thrift institutions should be placed on a uniform and equal basis and on as comparable a basis as possible with the taxable income of other corporations.	
K.	The Shares Tax on commercial banks and title insurance companies should be replaced with an excise using the same income base and rate as is applied to thrift institutions. In addition, the deduction for federal income tax paid should be restored to the income tax base.	
L.	The Gross Premiums Tax should be imposed on all insurance companies (including non-profit) without regard to whether the company is foreign or domestic, stock or mutual. Excluding non-profit 9.3 Non-profit 10.00 TOTAL	19.3
M.	The Corporate Net Income Tax and the Capital Stock Tax (wherever possible) should be imposed on all insurance companies.	5/
N.	All insurance companies which are subject to and pay the Corporate Net Income Tax and/or the Capital Stock Tax should be allowed a credit to be applied against their gross premiums tax for the payment of these taxes.	-3.0 6/

5/ No reliable estimate is immediately available on revenue gain under CNI and Capital Stock. However, whatever the gain, a corresponding amount must be deducted from the Gross Premiums Tax as a result of the tax credit to be granted.

6/ Based on presently levied Corporate Net Income and Capital Stock Taxes.

Revenue Gain or Loss

O. CAPITAL STOCK-FRANCHISE TAX

1. The base of the tax be changed and made more certain by the use of a fixed-formula method of computation employing capital, surplus, and undivided profits. — 7/
2. A one mill increase from seven to eight mills on a temporary basis to assure stability to yield in revenue as a result of basic change recommended in Q 1 above. — 8/
3. The apportionment factors employed in the "Uniform Division of Income for Tax Purposes Act" be adopted for the Capital Stock-Franchise Tax with the exception of Section 16 (b) relating to the state of origin under certain circumstances in the allocation of sales of tangible property.
4. The manufacturing, processing, and research and development exemption be continued for the present, but its suspension be considered as a revenue source if needed. If exemption is suspended, a $50.0 million revenue gain will be realized.
5. All corporations be required to pay a minimum annual tax of One Hundred Dollars in order to help offset the rapidly increasing costs of administration.

R. TAXATION OF INTERSTATE BUSINESS

1. The Committee recommends that the Legislature enact the Multi-State Tax Compact.
2. The Committee recommends the enactment of the "Uniform Division of Income for Tax Purposes Act" to replace the "headquarters" concept with the "destination" concept.
3. The Committee recommends that the Corporate Income Tax and Capital Stock and Franchise Taxes be amended to conform to the Corporate Net Income Tax as contained in the previous recommendations.

S. TAX RELIEF FOR SENIOR CITIZENS

1. The Committee recommends immediate enactment of legislation similar to House Bill 103 of the 1969-1970 Session, to provide interim relief for senior citizens.

7/ and 8/
A change to a "net worth" base brings simplicity and certainty of taxation. However, the Committee is not certain whether such change will bring a revenue loss or gain, and, therefore, recommends a temporary 1 mill increase. The 18.5 million increase has been estimated on existing base.

2. The Committee further recommends continuing study of this matter by the proposed Permanent Tax Reform Advisory Committee.

T. PERMANENT TAX REFORM ADVISORY COMMITTEE

The Committee recommends the creation of a permanent joint House and Senate Tax Reform Advisory Committee to study the tax structure of the Commonwealth on a continuing basis.

SUMMARY OF REVENUE GAINS & LOSSES

Sales Tax

Losses

Sales tax reduced 2 %	332.0	
Restaurant meals under 26¢(4%)	5.2	
TOTAL LOSS	337.2	337.2

Gains (4% rate)

Eliminate production exemption	60.0	
Trade-in	24.8	
Magazines & periodicals	7.2	
Liquor mark-up	10.4	
Candy, chewing gum	6.4	
	108.8	
Other elimination (Est.)	29.0	
TOTAL EST. GAIN	137.8	137.8
NET LOSS		-199.4

Business Taxes

Losses

CNI-12% to 10%	86.0	
Domestic & foreign repealed	8.0	
Corporate losses repealed	2.9	
CNI & CS tax credit	3.0	
GROSS LOSS	99.0	99.0

Gains

Destination basis (Est	5.0	
Dividends (Est.	15.0	
Ins premiums (including non-profits)	19.3	
CS & Franchise (1 mill increase)	18.5	
Eliminate mfg. exemption CS (Estimated on present base)	50.0	
GROSS GAIN	107.8	107.8
NET GAIN		+ 8.8

NET RESULTS SALES TAX & BUSINESS -190.6

FOREWORD

THE NEED FOR TAX REFORM

On March 7, 1970, the Speaker of the Pennsylvania House of Representatives established a Special House Committee on Tax Reform.

The purpose of the Committee was to conduct a comprehensive study of the entire State and local tax structure of the Commonwealth of Pennsylvania which would seek to achieve the following objectives:

1. Reform -- based on an equitable distribution of the tax burden.
2. Fiscal Stability -- based upon a tax system responsive to economic growth and capable of providing government with the revenue necessary to enable it to meet its obligations to its citizens.
3. Simplicity -- based upon uniformity of taxation, elimination of multiplicity of taxation and ease of administration.

The Committee's function was not to examine present or future budgetary requirements for any level of government nor did it endeavor to style or tailor any tax proposals to accommodate the existing fiscal crisis. A determination as to the amount of revenue needed in any fiscal period is solely the prerogative of the Legislature. While the Committee was not insensitive to the current fiscal crisis, the principal goal of the Committee was to propose a tax structure which incorporated the above-stated aims. The Committee, wherever possible, did examine revenue estimates involving proposed tax measures, but it did so principally for the purpose of evaluating the impact which might ensue as the consequence of formulating broad tax reform guidelines and not for the purpose of presenting a balanced expenditure-revenue budget for any fiscal year.

Taxes are, indeed, the price we pay for civilization. But surely civilized men and women can devise a tax system based on concepts of fairness to those required to pay them, with due consideration for those whose physical or economic condition may make taxation an onerous burden.

Criticism of Pennsylvania's State and local tax systems for lack of equity is nothing new. Tax study groups have made repeated recommendations for the easing of constitutional bans to permit a progressively graded tax according to the income levels of taxpayers. Much has been said; little has been done in this direction. As a result, tax inequity has become cumulative with each new piece-meal enactment of tax legislation in lieu of systematic tax reform. Enactment of these measures has created a growing public awareness that much is wrong with the way revenues are raised in the Commonwealth.

In the main two factors have historically inhibited tax reform in Pennsylvania - first, State constitutional limitations as interpreted by the State Supreme Court and, second, the "untimely and panic response" to pressures of new revenue needs, which has tended to preclude careful attention to what kind of system was developing. The pressure for new revenue continues unabated. The current crisis of the Commonwealth - the latest in a long series of fiscal crises - threatens to aggravate the now obvious tax injustices into which the Commonwealth has drifted. Someone once said that, "Nothing is so powerful as an idea whose time has come." The time for tax reform, long gathering, has now come in Pennsylvania.

The first-mentioned obstacle to modern tax reform in Pennsylvania has diminished, substantially so, with the adoption of new constitutional provisions in 1968.

LEGAL HISTORY

Prior to 1968, the oft-mentioned "uniformity clause" - "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying

the tax," - appeared in Article IX, Section 1 of the Pennsylvania Constitution. This section also set forth various exemptions which the Legislature was permitted to grant from property taxes, for example, places of religious worship, institutions of public charity, etc. The next section, Section 2 of Article IX, provided: "All laws exempting property from taxation, other than the property above enumerated shall be void." (This is now Section 5 of Article VIII).

The Pennsylvania Supreme Court has long held that the "uniformity clause" prohibited the Legislature from enacting a graduated income tax, that is, a law in which higher tax rates are progressively applied to higher income brackets in contrast to lower income levels. The court has also held that these provisions bar the Legislature from creating any tax exempt classifications based upon quantitative equitable standards such as the amount of income and number of dependents of the taxpayer.[1/] In fact, as late as 1964 the court invalidated local occupational privilege taxes containing exemptions for persons whose earnings did not exceed six hundred dollars ($600) a year.[2/]

In contrast, the courts during these years have sustained preferential tax "exclusions" for certain industries from both State and local taxes. For example, the specialized structures of manufacturers and public utility companies are held to be almost totally immune from local real estate taxes.[3/]

As a consequence of the precedents thus established, similar tax relief was granted to such firms from the sales and use tax (the "Tax for Education"). The nature of such provisions in the tax structure and, more importantly, the almost total absence of equitable considerations of family income and dependency in individual taxes substantially contributes to Pennsylvania having one of the least equitable local and State tax systems. This has been true because of the heavy reliance upon realty and sales taxes to meet local and school district needs.

Uniquely enough, Pennsylvania is not regarded as a "high tax State" according to commonly used criteria in making state comparisons. It is true, for example, that when the sum of State and local taxes collected in Pennsylvania is divided by population, the resulting tax per person is less than the overall average for the States. It is also true that total taxes in Pennsylvania in relation to total income in the State places Pennsylvania in a favorable nationwide position. But, neither of these commonly-mentioned criteria for making tax comparisons furnishes any idea as to how our total tax burden is shared among our taxpayers nor discloses whether equitable standards based on personal income levels and family dependency are being followed. In Pennsylvania, it is apparent that because of the preponderance of local wage taxes, property tax and State sales tax, low to middle income families pay a substantially larger proportion of their income in taxes than do families with higher incomes. This is the reverse of equitable, progressive taxation.

RECENT CONSTITUTIONAL AMENDMENTS

The first successful effort to introduce a personal exemption based on income level in Pennsylvania occurred in 1965, when Article IX, Section 1 of the State Constitution was amended by adding the following provision:

> "Any taxing authority may exempt from occupation privilege taxes, persons deriving less than one thousand dollars per year from such occupation."

The new Constitution of 1968, while omitting the 1965 provision now commendably permits the Legislature to enact tax measures containing special provisions giving weight to personal exemptions, taxpayer's income and family dependents among others. In the new Constitution, the tax provisions appear in Article VIII. The "uniformity clause" appears in Section 1 of this article in the same language as the former Constitution, but Section 2 provides in part as follows:

"Section 2. . .

(b) The General Assembly may, by law: . . .(ii) Establish as a class or classes of subjects of taxation the property or privileges of persons who, because of age, disability, infirmity or poverty are determined to be in need of tax exemption or of special tax provisions, and for any such class or classes, uniform standards and qualifications. . ." (emphasis added).

Although taxes on income are not expressly mentioned in this provision, the Supreme Court has held that taxes on income are to be regarded as property taxes. In view of this specific constitutional authorization to classify and exempt on the basis of "need," there are no legal impediments to the Legislature's valid enactment of uniform measures for local and State taxation of income with special provisions for taxpayers' income levels, age, physical condition and poverty.

In the Committee's view, this recent liberalization of our traditionally rigid "uniformity" requirement in Pennsylvania tax law is the most significant single factor and promising tool for tax reform along equitable lines. The methods for accomplishing this phase of tax reform are detailed in other sections of this Report dealing with a proposed personal income tax and with recommended revisions of our haphazard local tax structure.

BUSINESS TAX REFORM

Of equal importance in tax reform is the necessity for providing a more equitable distribution of taxes paid by the business community.

Pennsylvania's economic climate should be such as to attract both firms considering new business locations and also to encourage the retention and expansion of Pennsylvania-based industry.

Although the Committee is aware of the fact that there are other important factors which influence plant location and expansion, our primary concern has been with the development of a healthy tax climate for business in Pennsylvania.

We are satisfied that the tax reforms we are recommending will serve both to strengthen rather than impair the "tax climate" and improve the image of Pennsylvania and its communities from the viewpoint of possible business location. These recommendations leave intact the freedom of business concerns from local property taxes on their tangible personal property (movable machinery and equipment and business inventories). These advantages and incentives, coupled with the recommended adjustments of other taxes should materially contribute to keeping Pennsylvania's tax climate favorable.

Taxes are but one of the costs that modern industry faces. Where public services are good and a skilled work force is available, business taxes are offset and become a secondary consideration. Most modern business is willing to pay its fair share of taxes, in the knowledge that it gets what it pays for in services affecting its growth and prosperity.

The elements of a healthy economy lie in upgraded educational opportunity, urban renewal, housing, transportation, water supply, clean air, resource conservation and the development of recreational areas. It takes these things to develop the skilled work force willing to remain in Pennsylvania, and which is the prime need of modern industry. Modern industry goes where modern public facilities and services are available to meet its needs.

Pennsylvania must develop a modern, equitable tax structure if it is to provide the wherewithall for balanced economic development. This tax structure must neither soak business nor grant special favors. It must be broadly based and progessive. It cannot be a tax structure which soaks those least able to pay while permitting those most able to pay to avoid their just share of the costs of government.

This report does not address itself to the problem of whether any stated ratio of consumer taxes to business taxes is economically or socially preferable. All such discussion

heretofore and the findings predicated thereon have taken into account only those taxes paid at the State level without considering the ratio of tax dollars paid to local government by consumers vis-a-vis those paid locally by business firms. Moreover, many taxes paid by business firms ultimately become consumer burdens so that in any realistic analysis of tax burdens they do not all belong in the business portion of such ratios. Similarly, it may be noted that business firms pay a portion of the sales tax, commonly regarded as a pure consumer tax. Thus, any attempt at definitive delineation of tax burdens is at best a speculative venture and one that poses a task of great difficulty.

REPORT AND RECOMMENDATIONS ON REFORM OF SALES AND USE TAXES

INTRODUCTION

One of the major areas of consideration to which the Speaker's Committee on Tax Reform has devoted its attention is that of sales and use taxation in Pennsylvania. Aside from any consideration dealing with the production of added revenue, it has become increasingly evident over the years that Pennsylvania's sales and use tax structure is in dire need of reform. The Committee, after carefully studying the tax structure and considering the views of a number of experts in the field (including the work of previous commissions), has generally concluded that:

1.) The tax rate is too high. At 6%, Pennsylvania has the highest sales tax rate in the nation,[1] and even though the total tax impact upon the consumer is somewhat alleviated by other factors discussed herein,[2] the psychological impact of Pennsylvania's 6% rate is unquestionably a significant factor in creating public discontent.

2.) The tax is regressive. All sales taxes are regressive, and it has been frequently demonstrated that the smaller wage earner in Pennsylvania pays a disproportionate share of sales taxes.[3] The higher the rate, the more inequitable the tax is despite the exemptions for food, clothing and entertainment.

3.) It is inequitable. The exemption pattern which has developed over the years unfairly favors certain privileged groups at the cost of others not so favored.[4]

4.) It is expensive and difficult to administer, both for the State and for business. The sales and use tax laws are riddled with highly technical distinctions and bookkeeping requirements which make the accounting for, reporting and auditing of sales and use taxes a nightmare for both businessmen and administrators.

In arriving at the foregoing general conclusions, the Committee and its staff gave careful consideration to detailed comprehensive studies of the Pennsylvania law and that of our sister states. The Pennsylvania Economy League supplied a number of detailed statistical and comparative studies which the Committee carefully perused. Several of these studies have been noted above and are attached hereto. The overall, general conclusion at which the Committee has arrived is that basic reform of the Sales Tax Act will require a far-reaching revision of the tax base, the elimination of numerous tax avoidance provisions, a tightening of the accounting and collection procedures (especially in the area of use taxation), and a general reduction in the tax rate.

The specific recommendations which follow do not, of course, represent the only possible direction in which sales and use tax reform can go. Some of the alternatives considered by the Committee, and the reasons for their rejection, will be discussed below. It was felt, however, that if the report of the Committee is to be meaningful, it must represent a single, unified and comprehensive proposal, rather than a series of separable alternatives.

It is the feeling of the Committee that the total "sales and use tax package" offered by this report represents such a comprehensive and consistent approach. It is an effort at tax reform in the field of sales and use taxation which will, we believe, reduce the infirmities of the existing tax structure, to the extent that any sales tax is capable of reform.

Recommendation No. 1.: Tax Rate and Base

The first recommendation of the Committee is that the general tax rate be reduced from 6% to 4%, and that the tax base be broadened in order to offset all or part of the revenue loss resulting from this reduction. The Committee has concluded that a reduction such as that recommended will both alleviate the regressive nature of the tax, and more equitably spread the financial burden. Further, the Committee has noted that of the 44 states which have a sales tax levy, 41 have rates of less than 5% (2% to 4.9%).[5/]

Of course, a reduction in the rate such as that contemplated must be accompanied by a thorough-going revision of the entire exemption structure, and adoption of the other measures discussed below.

Recommendation No. 2.: Production Exemptions

Except as limited by the "resale exemption" further discussed below, it is recommended that all of the "production" exemptions be eliminated.[6/] This means that the existing exemption upon capital investment in machinery, equipment, foundations, etc., purchased by persons engaged in production activities, which purchases are now generally exempt, would be subject to the tax. Persons engaged in such businesses would continue to have a tax exemption with respect to property which is used or consumed in the production process, the general test being that the exemption would apply to property which is either resold in its original or altered form, or expensed for federal tax purposes within one year of the date of acquisition.

The adoption of this recommendation would have the effect of eliminating a major inequity in the present law. By combining a substantial reduction in rate with the elimination of these "special privilege" exemptions, business people who invest in capital equipment would no longer be discriminated against because they have chosen to invest in one type of business over another.

Under the present law, a businessman who invests capital in a retail business, or in a service business, is penalized by the imposition of a 6% tax upon his capital investment, while the businessman who choses to put his capital investment into a "production" business is free of this tax burden. The Committee sees no reason to continue this inequitable tax pattern in Pennsylvania. The concept of granting special tax exemptions to manufacturers, utilities, etc., is an old one in Pennsylvania and it has led to a veritable flood of litigation over the years. The constant unremitting efforts of special interest groups, each advocating its share of the pie, have led to the perennial parade of lobbyists who have written our tax laws by bits and pieces over the years. The history of the sales tax law, in particular, is a case study in such special privilege lobbying.[7/]

Advantages of complete elimination of the so-called production exemptions, as compared to the mere piecemeal amendment thereof, become apparent when the alternatives are considered.[8/] Those alternatives are:

A.) Elimination of the so-called "foundations" exemption for property incorporated into real estate used as a foundation for production, operation, machinery or equipment. This exemption was placed in the law April 15, 1959, primarily for the benefit of contractors (although, incidentally, also to the benefit of the purchaser of the contract).

B.) Redefinition of the term "manufacturer": The present technical definition of "manufacturer" combined with the so-called "direct use" and "predominate use" tests, have led to a great deal of litigation and uncertainty in the courts. The sales tax definition of manu-

facturing differs markedly from the traditional common law definition, and it is far beyond what the courts have traditionally determined to be manufacturing under other tax laws of the Commonwealth and under the repealed consumer sales tax law of 1953. A change in this definition would narrow the tax base by restricting the number of persons entitled to the exemption, i.e., there would be fewer "manufacturers" than there are today, but those privileged few would continue to be entitled to the exemption. This result would intensify the inequity in the present exemption pattern, which favors certain specified types of investment capital over others.

C.) The third alternative considered by the Committee was a return to the definition of the Consumer Sales Tax law of 1953, which provided for an exemption only for property which was an ingredient or component part of the product or which was consumed in the production process. This alternative has been substantially adopted by the Committee, except that the informal ruling which governed the question: What property is consumed in the production process?, has been adopted as a part of the recommendation in chief.

D.) If we do not adopt the "production" approach, there are several alternatives dealing with the public utilities exemption which would present themselves. Thought would have to be carefully given to the question of whether the doctrine of the McHugh case would be repealed.[9/] That case eliminated, by its decision, the so-called "exclusive use theory", under which exemptions in the sales tax law could be applied only for the benefit of the immediate user, and not for the benefit of a construction contractor or other intermediary. It would also be necessary to review the scope of the utilities exemption with respect to whether its application to common carriers should be restricted, whether motor vehicles utilized by nontransportation utilities should be exempted, etc.

The same sort of deliberations would govern the approach to each and all of the listed "production activities", such as research, the several processing operations, agriculture,

mining and shipbuilding. The Committee determined that this sort of piecemeal approach, ledning itself as it does to the kind of lobbying pressures which are difficult to resist, should be avoided. As the matter was under consideration by the Committee, it became more and more evident that a consistent approach, dealing impartially with all investment capital, is vastly preferable to an attempt to whack up each of these exemptions on its own terms. The effect of eliminating these exemptions has been considered and it is projected that elimination thereof would produce $15 million in additional revenue per year per percent of tax. In other words, at a 4% rate, $60 million in additional revenue would be produced.[10/]

Recommendation No. 3.: Elimination of Other Exemptions and Exclusions

In addition to the elimination of the "production exemption", the Committee recommends elimination of the following exemptions and exclusions:

1.) The exclusion for delivery, installation or application charges when separately stated.

2.) Elimination of the trade-in allowance.

3.) Elimination of the "demonstrator" exemption.

4.) Elimination of the "isolated transaction" exemption.

5.) Elimination of the broadcasting and television exemptions.

6.) Elimination of the ship repair exemption, and so much of the ship's stores and supplies exemption as applied to the purchase of such property for the equipping of a new ship.

7.) Elimination of the exemption for mail order catalogues and direct mail advertising materials.

8.) Elimination of the exemption for rail transportation equipment.

9.) Elimination of the fee fishing exemption.

10.) Elimination of the exemption on magazines and periodicals except newspapers.

11.) Elimination of the exemption on restaurant meals sold by hospitals.

12.) Elimination of the alternate imposition provisions.

13.) Elimination of the interstate commerce exemptions of Section 2 (n) and 2 (h) of the Act, except insofar as said exemptions are mandated by the Federal Constitution. 13/

The foregoing recommendations are based upon the following factors:

1.) Under the present Act, charges made for the delivery, installation or application of personal property are deductible from the tax base, when such charges are separately stated (Act, Section 2 (f) [1]). This, however, is in conflict with the provisions dealing with repairs. The Act taxes the performance of services such as printing, cleaning, repairing, altering, etc., whether or not the value of the personal property so transferred is separately stated from charges for the services. It is the judgment of the Committee that this inconsistency should be eliminated and that the proper means of eliminating it is to tax all charges for services performed in conjunction with the sale of merchandise.

2.) The Pennsylvania law permits a deduction from the purchase price on account of the value of property taken by the seller in lieu of cash as a "trade-in". The value of "trade-in" property should be deemed a part of the purchase price, and in fact, the allowance of the "trade-in" is in conflict with the general definition of the general term purchase price. That definition generally includes "the total value of anything paid or delivered, or promised to be paid or delivered, <u>whether it be money or otherwise</u> . . ." Act, Section 2 (f) [1]. It might be noted that, of the three leading sales tax states, California, Illinois and Michigan, only Illinois has a trade-in allowance. Both California and Michigan tax the trade-in. Further, it might

be pointed out that the reduction in rate from 6% to 4% effectively offsets the trade-in allowance. Thus, the purchaser of a new car who trades in an old car valued at approximately half the retail price of the new car will pay little additional tax over that which he would pay under the present 6% rate with the allowance.

3.) The "demonstrator" exemption is a special exemption given to dealers for property used by them as a "demonstrator" in the course of their business. We have been able to find no other state which allows such an exemption.

4.) The "isolated transaction" exemption exempts the sale of items (except automobiles) with respect to which the seller is not a regular dealer. Initially, the proposal was made that this exemption be eliminated at least so far as the articles sold are "registered" or "licensed" or are otherwise subject to surveillance and control by the Commonwealth. However, it was felt that better practice would be to eliminate the exemption completely, thus rendering all such sales theoretically subject to the tax. It is not fair to retailers to have to compete with unlicensed and unregistered sellers who fail to collect the sales tax, especially with the buyer free of any obligation to declare and pay use tax, as under the existing law.

5.) The broadcasting and television exemptions grant a unique privilege to persons engaged in the business of broadcasting and television. They are exempted under existing law, upon all personal property directly used in broadcasting, an exemption even broader than the usual "production activities" exemption in that it includes office equipment, etc. The Committee sees no reason why this privileged area should continue to be carved out of the sales tax law.

6.) Shipbuilding and ship repair has been a privileged activity in the Commonwealth since the Selective Sales and Use Tax Act was enacted. The Committee can find no economic or other justification for the continuance of this special exemption. Persons engaged in the business of manufacturing ships should be given the same exemption status as other manufacturers; i.e., ingredients incorporated into the ship, including ship's stores and supplies which are furnished for a new ship, would be exempt. This is the law in Maryland. With respect to fuel, provisions, ship's stores and supplies, such items should be exempt if purchased for predominant use in interstate or foreign commerce; however, we should follow the sales tax provisions of New York and New Jersey which tax such items when they are not purchased for use outside Pennsylvania waters.[11]

7.) The special exemption for mail order catalogues and direct mail advertising materials is another such exemption which has given persons in this business a status comparable to that enjoyed by charitable institutions. The Committee feels that the exemption should be eliminated. Parenthetically, the Committee has given careful thought to the imposition of the sales and use tax upon the furnishing of advertising services, but has determined that it would be difficult to administer and enforce such a tax.

8.) The exemption for rail transportation equipment is most peculiar; it applies not only to railroad companies but to all owners of rail transportation equipment, and exempts such equipment regardless of any other tax status of the owner. This is a glaring example of a special privilege exemption, and it should be eliminated.

9.) The fee fishing exemption, although a minor one, represents the overturning of ten years of Department of Revenue policy. The theory upon which this exemption was granted is that fish caught at a fee fishing lake are "food" equivalent to fish purchased at a grocery store. Clearly, this is not the case, and the exemption should be stricken.

10.) The Committee feels that the exemption on magazines and periodicals, except on newspapers, should be eliminated. Elimination of this exemption will create $1.8 million in revenue for each percent of tax, or, at 4%, $7.2 million.

11.) The Committee felt that restaurant meals sold by hospitals should be taxable, but that the exemption for such meals sold by schools and churches should continue.

12.) The "alternate imposition provisions" provide that where property is purchased outside Pennsylvania for use outside this Commonwealth, and is subsequently brought into Pennsylvania for a period not to exceed six months, the tax may be paid upon a special tax base, equal to 6% of the fair rental value for the actual period of use, not to exceed six months. This provision gives out-of-state contractors a competitive advantage over Pennsylvania contractors who are required to pay the tax on their equipment upon the full purchase price. This is an example of an inequity created by special exemption provisions in the Act, and it should be eliminated.

13.) The interstate commerce exemptions[12/] have to do with the acquisition of property for the purposes of transporting it outside the Commonwealth in its original form, or as an ingredient of other property which will subsequently be transferred outside the Commonwealth. This exclusion, which is broader than any found in any other state sales tax act, constitutes a substantial loophole. It enables corporations to use Pennsylvania as a storage or warehousing state, witho subjecting themselves to an inventory or personal property tax, and without having to pay a sales tax. Theoretically, any portion of any property originally acquired for transportation to other states which is taken out of the shipment and used in Pennsylvania is subject to a use tax. But, as a practical matter, this tax cannot be collected except on voluntary declarations or audit. The Committee's recommendation is that the language in Sections 2 (h) and 2 (n) excluding property in interstate and foreign commerce should be eliminated, and replaced by a simple statement to the effect that: "The tax shall not apply to property in interstate or foreign commerce."

This is the approach which most of the other states use, and would mean that the exemption would be limited to the narrow, but well defined, field of exclusion established by case law.

Recommendation No. 4

In addition to the foregoing, the following recommendations for other changes in the Act were agreed to:

1.) The tax on alcoholic beverages shall be computed upon a retail basis, rather than upon the wholesale price.

2.) The tax shall be imposed upon candy, chewing gum, and similar confections; however, there shall be a 25¢ exemption on such confections and on restaurant meals.

3.) Specific language be added to the Act authorizing the Commonwealth to enter into compacts with other states for the collection of sales and use taxes of those states on a reciprocal basis.

4.) The tax be imposed upon charges for moving household goods and furnishings and business equipment and supplies in the process of relocation from one permanent location to another.

5.) The use tax reporting and collection provisions be strengthened in the following manner:

A.) A provision be added that the resale exemption is merely presumptive unless and until the person claiming the exemption reports the actual resale to the Department of Revenue.

B.) Evasion of the use tax should be punishable by more stringent criminal and civil penalties and more use of the bonding provisions of the Act should be made.

C.) The "arms length transaction" provisions of the Act be amended to establish a presumption with respect to subsidiary or controlled corporations which sell to affiliates or parents.[14]

The foregoing recommendations are based upon the following considerations:

1.) At the present time, the tax upon alcoholic beverages is collected by the State liquor stores from licensees who purchase the same for use in licensed establishments, and the tax is based upon the wholesale price to the licensee. It has been proposed that sales of alcoholic beverages across the bar, by the drink, ought to be made subject to the tax, but this proposal has been considered inappropriate by the Committee, for several reasons, chief among them being the additional cost of administering and enforcing the requirement. However, it would be easy to compute the tax on alcoholic beverages upon a retail basis, and for the State liquor store to collect it from the licensees on that basis. This is the recommendation which the Committee adopted, and which it now recommends.

2.) At the present time, all food items are exempt from the tax, and there is no exemption from the tax on restaurant meals (except for the basic 10¢ exemption). The Committee determined that it would not be a hardship on the consumer to impose the tax on candy, chewing gum and similar confections, providing that a 25¢ exemption on such confections and upon restaurant meals be added.

3.) It is proposed that specific language be added to the Act authorizing the Commonwealth to enter into compacts with other states for actual collection of the sales and use taxes of those states on a reciprocal basis. Although there is general compact language in the Act, in the opinion of the Committee it does not extend to the actual collection of the taxes of other states on a reciprocal basis. There is a proposal before the Multi-State Tax Commission which would, if finally enacted, create a federal interstate sales and use tax collection system under the terms of which merchandise sold in interstate commerce would be taxed by the state of destination, but the actual collection of the tax would be made by the state of origin. Should such a provision be enacted, it would resolve the problem, but we

would still need enabling language in our Act. In adopting such language, however, we should not restrict ourselves to any specific tax collection plan. It might be noted that such language would help to alleviate the doubts which may exist with respect to the equity of strict enforcement of the interstate commerce exclusion.

4.) The Committee recommends that the tax be imposed upon charges made for moving household goods and business property for relocation from one permanent place to another. The additional revenue realized by this added tax will help to offset some of the revenue loss occasioned by other tax reform measures recommended. It is felt that this non-recurring expense is not regressive in nature, and will not impose an undue tax burden upon persons who cannot afford to pay it.

5.) The present use tax reporting and collection procedures are, in the judgment of the Committee, inadequate. Although a number of efforts have been made to strengthen the use tax provisions of the Act, one of the major economic problems which the use tax creates is the competitive disadvantage which Pennsylvania merchants must suffer at the hands of merchants in surrounding states who sell goods to Pennsylvania customers without collecting sales tax, and without adequate provision for collection of the use tax. Of course, reduction of the overall rate to 4% will alleviate the problem to a considerable extent, but it is none the less proposed that the following additional enforcement measures be incorporated into the law:

A.) A requirement that the resale exemption be merely presumptive unless and until the person claiming the exemption reports the actual resale to the Department of Revenue. With respect to retail sales, it would be sufficient to require the seller claiming the resale exemption to identify the purchaser as a licensed Pennsylvania retailer. It is our idea that this could help plug a substantial use tax loophole.

B.) The penalties, both civil and criminal, for evasion of the use tax, ought to be stiffened, including a provision that property upon which the use tax has been evaded

may be determined contraband and subject to confiscation. In addition, the bonding provisions under the existing law should be used more stringently.

C.) In order to avoid the use of a tax evasion device involving affiliate or subsidiary corporations, the Committee recommends that the "arms length transaction" provisions of the Act be amended to establish a presumption with respect to subsidiary or controlled corporations which sell to parents or affiliates. Such transactions ought to be presumed taxable, and the burden of establishing a legitimate business purpose should be placed upon the taxpayer.

FOOTNOTES

1. Table 1, attached.

2. Tables 2 and 3, attached.

3. Table 4, attached.

4. Memorandum, "The Sales Tax Exemption Pattern", attached.

5. Table 1; see also, Table 5, attached.

6. The following activities are included within the phrase "production activities":

    A.) Manufacturing, including packaging.

    B.) Publishing and printing.

    C.) Mining, refining, quarrying and processing natural resources.

    D.) Building, repairing and rebuilding commercial ships.

    E.) Research.

    F.) Processing, which includes:

    1.) Commercial food preparation (canning, freezing, etc.).

    2.) Preparation of fibers and fabrics.

    3.) Coating processes and heat treating.

    4.) Rolling, drawing or extruding metals.

    5.) Metal fabrication.

    6.) Preparing animal food.

    7.) Bottling.

    8.) Lumber mill operations.

    9.) Grain milling.

    10.) Slaughterhouse operations.

    11.) Processing used lubricating oil.

G.) Agriculture.

H.) Public utilities service, including producing, delivering or rendering same and constructing, reconstructing, remodeling, repairing and maintaining facilities used for such service, including real estate other than buildings.

7. Memorandum, "The Sales Tax Exemption Pattern".

8. Memorandum, "Sales Tax Regulations", attached.

9. Commonwealth v. Charles McHugh, 406 Pa. 566.

10. Table 6, attached.

11. Memorandum, "Shipping and Interstate Commerce Exemptions", attached.

12. Memorandum, "Shipping and Interstate Commerce Exemptions".

13. In studying the economic impact of the removal of these exemptions and exclusions, the Committee was, in certain instances, unable to arrive at reliable and definite cost figures. However, it is our judgment that substantial revenue increases may be anticipated as a result of these changes. Such increases are especially likely with regard to the elimination of the delivery, application and installation exclusions and the changes in the interstate commerce exemptions.

14. It is anticipated that improved enforcement efficiency resulting from these changes will produce a substantial but indeterminable amount of additional revenue.

Table 1
State Sales Tax Rates (Percent)
Pennsylvania and 43 Other Sales Tax States,
Fiscal Year Ending in 1969

Pennsylvania: Sales Tax Rate (Percent) 6%
Rank (high to low) Among 44 States 1st

44 State Summary	Number of States	% to Total
2% to 2.9% Rate	6	13.6%
3 to 3.9	25	56.8
4 to 4.9	10	22.7
5 to 5.9	2	4.5
6 to 6.9	1	2.3
	44	100.0%

Source: U.S. Bureau of the Census, Governmental Finances in 1969

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Table 2
Estimated State Sales Tax Base[a] As Percent of Personal Income
Pennsylvania and 43 Other Sales Tax States
Fiscal Year Ending in 1969

Pennsylvania: Est. Sales Tax Base As % of Personal Income — 37.0%
Rank (high to low) Among 44 States — 41st

44 State Summary	Number of States	% to Total
25% to 44.9%	9	20.4%
45 to 64.9	14	31.8
65 to 84.9	14	31.8
85 and over	7	16.0
		100.0%

a/ Estimated sales tax base: tax collections capitalized at prevailing tax rates.

Source: U.S. Bureau of the Census, Governmental Finances in 1969

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Table 3
Taxable Status of Selected Commodities and Services
Pennsylvania and Three Leading Sales Tax States
As of April 28, 1970
Symbols: T - Taxable; X - Exempt

	Calif.	Ill.	Mich.	PENNA.
Property Used or Consumed in Production				
Machinery, tools and equipment	T	T	X 3/	X 3/
Fuel	T	T	X 3/	X 3/
Food				
Consumed off-premises where sold	X	T	T	X
Other Commodities				
Prescription medicines	X	T	X 4/	X
Farm products	T	T	T	X
Alcoholic beverages	T	T	T	T 5/
Cigarettes	T	T	T	X
Clothing	T	T	T	X
Trade-In Deduction	T	X	T	X
Utility Services				
Water - domestic	X	X	X	X
Transportation	X	X	X	X
Telephone and telegraph	X	X	T	T
Gas and electricity	X	X	T	T
Other Services				
Admissions	X 1/	X	X	X
Newspapers	X	X	X	X
Beauty and Barber	X	X 2/	X	X

1/ Except for admission fee on closed circuit telecasts of boxing and wrestling matches.
2/ Except property sold in connection with the service is taxable under service occupation sales and use tax.
3/ If used "directly" in manufacturing, processing, etc.
4/ Only to 50 percent of the amount charged for recorded drug prescriptions. Full exemption applies to artificial limbs and eyes.
5/ Tax paid on all sales at liquor stores and beer distributors. Sales at bars are exempt.

Source: Commerce Clearing House, Inc.

May 27, 1970

Table 4
Impact and Effective Tax Rate of Pennsylvania State Sales Tax on Individual Income Classes

Adjusted Gross Income Class	% of Total Returns[a]	% of Adj. Gross Income[a]	% of Est. Sales Tax Yield[a,b]	Effective Tax Rate[c]
Total	100.00%	100.00%	100.00%	1.22%[a]
$ 2,000 under $3,000	10.11	3.06	4.17	1.66
3,000 under 4,000	10.28	4.28	5.55	1.58
4,000 under 5,000	9.61	5.19	6.41	1.50
5,000 under 6,000	9.25	6.07	7.17	1.44
6,000 under 7,000	10.26	7.96	9.06	1.38
7,000 under 8,000	10.36	9.24	10.26	1.35
8,000 under 9,000	9.02	9.15	9.91	1.32
9,000 under 10,000	7.20	8.17	8.62	1.28
10,000 under 15,000	16.73	23.73	23.30	1.20
15,000 under 20,000	3.77	7.64	7.00	1.11
20,000 under 50,000	2.90	9.81	7.10	.88
50,000 under 100,000	.40	3.20	.99	.38
100,000 under 200,000	.08	1.24	.35	.34
200,000 or more	.02	1.24	.10	.10

Note: Excludes sales tax paid on the purchase of an automobile.

a/ With adjusted gross income of $2,000 and over. Excludes adjusted gross income $2,000 and under, see b/ below. Of the total returns, 20 percent had adjusted gross income of less than $2,000, and accounted for only three percent of total adjusted gross income.

b/ Estimated on basis of number of tax returns and federal optional state sales tax table for Pennsylvania family of 4 or under. Detail not available for income classes under $3,000; table shows flat amount for $3,000 and under.

c/ Sales tax yield as percent of adjusted gross income.

Source: Form 1040 Instructions, Internal Revenue Service 1969; Statistics of Income 1967, Individual Income Tax Returns, Internal Revenue Service.

May 27, 1970

Table 5
State and Local Sales Taxes, January 1, 1970

	State Rate	Local Rate (Max.)
	(Percentage Rate)	
Alabama	4	2a/
Alaska	-	5b,c/
Arizona	3	1c/
Arkansas	3	1
California	4	1*d/
Colorado	3	2a/
Connecticut	5	-
Florida	4	-
Georgia	3	-
Hawaii	4	-
Idaho	3	-
Illinois	4	1
Indiana	2	-
Iowa	3	-
Kansas	3	-
Kentucky	5	-
Louisiana	2	2c/
Maine	5	-
Maryland	4	-
Massachusetts	3	
Michigan	4	-
Minnesota	3	1
Mississippi	5	-
Missouri	3	1e/
Nebraska	2½	½
Nevada	2	1½*f/
New Jersey	3	-
New Mexico	4	½*
New York	3	3*
North Carolina	3	1*g/
North Dakota	4	-
Ohio	4	0.5h/
Oklahoma	2	1*
Oregon	-	e/
PENNSYLVANIA	6	0.6
Rhode Island	5	-
South Carolina	4	-
South Dakota	4	0.5
Tennessee	3	1.5*
Texas	3¼	1*
Utah	4	0.5*
Vermont	3	-
Virginia	3	1*
Washington	4.5	-
West Virginia	3	-
Wisconsin	4	0.5e/
Wyoming	3	-
District of Columbia	4	-

Footnotes and Source

Table 5

* Uniform State-collection of local sales taxes.

a/ Locally collected in some jurisdictions, State collected in others.

b/ In Fairbanks, the combined city - borough rate is five percent.

c/ All local taxes self-administered.

d/ Local governments impose State-collected one percent taxes.

e/ Local tax authorized, but none presently imposed.

f/ A one percent county tax is mandatory.

g/ Imposed in Mecklenburg County only.

h/ State-collected county sales taxes authorized in 1967; none imposed yet

Source: Advisory Commission on Intergovernmental Relations, An Information Report, State and Local Finances, Significant Features 1967 to 1970, November, 1969.

MEMORANDUM

SUBJECT: THE SALES TAX EXEMPTION PATTERN–
A Study in Privilege Legislation

TO: The Honorable Herbert Fineman
Speaker of the House

FROM: Gerald H. Goldberg
Assistant Chief Counsel

INTRODUCTION

The evolution of Pennsylvania's Sales Tax Law, from the old 1% Consumers Sales Tax of 1953[1] to the present Tax Act of 1963 for Education,[2] demonstrates a clear pattern in the development of privilege legislation. As will be shown in this memo, legislatures under every Governor from George Leader to the present, have steadily eroded the tax base in those special areas such as manufacturing, railroading, mining, the public utilities and others–while at the same time increasing the general rate of the tax and broadening the tax base with regard to the general consumer public. Frequently, the very same amendment or set of amendments which significantly broadened the exemptions given to the privileged areas of the business community at the same time raised the tax rate or broadened the tax base for the consumer.

It must also be mentioned, in general that administrative personnel made a conscientious effort to collect the tax from the big industrial concerns of the Commonwealth. Large sums of money and great investments in man hours were devoted to cases before the Commonwealth Court, defending the tax base against inroads. These efforts were, in large part, successful in the courts (with a few notable exceptions) but, as will be shown, as soon as the Court would sustain a "tough" position on the part of the administrators, the legislature "corrected" the situation by promptly undoing the decision legislatively.

Finally, it should be noted that the most numerous business groups in Pennsylvania - the retailers - have not received special privilege treatment. On the contrary, this group (which comprises most of the small businessmen who are the subject of so many crocodile tears) has been discriminated against, penalized, and generally made the subject of tough sales tax treatment over the years.

THE STRUCTURE OF THE EXEMPTION PATTERN

So that you may understand the evolution of the exemption pattern, it must first be realized that the law was initially structured in such a way as to make the granting of special privilege exemptions both easy and inobvious. The "selective" language of the tax made it easy to exclude the items of property simply by failing to include it in the definition of "tangible personal property." A good example of this sort of treatment is found in the Rohm & Haas case,[3] in which the Court held that railroad tank cars were not "tangible personal property"[4] because they were not designated as such, although other transportation equipment was so designated. The definitions of the terms "sale at retail"[5] and "use"[6] furnished a second area for exemption treatment, as did the definition of the term "resale."[7] Finally, the Act contained another exemption section which carved out certain types of businesses and activities for exemption.[8] For example, all of the communication media were exempted from the beginning - radio, television,[9] newspaper and magazine publishing,[10] advertising media,[11] even the motion picture business.[12] Thus, it may be seen that the pattern of the Act was such that exemption and exclusion language could be scattered throughout, and could be carefully tailored to meet the needs of the business seeking the exemption. In some cases, notably, the ship building and repairing business - the recipients of the privilege treatment were so conscientious as to use more than one of these exemption section. Like the well-known conservative who wore both a belt and suspenders, the Sun Ship people insisted that their exemption be written into the "manufacturing" exemption,[13] "the sale at retail" exemption;[14] the "use" exemption [15] and also the separate exemption section.[16] The representatives of that industry thus employed every possible means of insuring that under no circumstances would any taxing agent have the temerity to show himself in or near any of Sun Ship's facilities.

THE MANUFACTURING EXEMPTION

So that you may understand in greater detail how the exemption pattern worked, I shall detail the development of the so-called manufacturing exemption from its inception.

The concept of granting an exemption from tax to manufacturers is not new in Pennsylvania. The Capital Stock Tax granted an exemption to manufacturers as early as 1885, for reasons which the court explained in Commonwealth vs. Northern Electrical Light and Power Co., 145 Pa. 105 (1891):

> "When the Act of 1885 was passed, laws had been made in adjoining states which gave encouragement to the establishment of factories by exempting them from certain forms of taxation. The mischief to be remedied was the danger that such legislation might lead to the removal of capital and labor from this state to others, to the detriment of the business and prosperity of our own. The remedy provided was the removal of the tax imposed by the Act of 1879 so as to remove the inducement to leave the State. - - - Since 1836 it had been the policy of the State to encourage ... manufacturing corporations ...".

The 1953 Consumers Sales Tax Act did not, however, contain a broad manufacturers' exemption. It exempted sales of property to be used in fabricating, compounding or manufacturing tangible personal property, which becomes an ingredient or component part of the product, or is consumed in the production process.[17] By regulation, the Department of Revenue broadened the exemption to cover machinery, equipment and supplies which were totally expensed in the production process within one year of the acquisition date, on the theory that these items were, in effect, "consumed".[18] Even so, the exemption applied only to "manufacture" as that term had traditionally been defined by the Courts.[19] The 1953 Capital Sales Tax Act contained no separate definition of the term, nor did the Capital Stock and Franchise Tax Act define the term "manufacture". However, there is a long line of well developed case law in Pennsylvania which has defined the term "manufacturing" in full detail. Without here reviewing all of the cases, suffice it to say that in general, the Courts have held that a thing is a manufactured article when the product is a new and different article with a distinctive name, character or use; and that manufacturing is the application of labor or skill to materials whereby the original articles are changed to a new, different and useful article, provided the process is of a kind popularly regarded as manufactured or the produce of such process.[20]

The Selective Sales and Use Tax Act of March 6th, 1956 P.L. (1955) 1228, initially continued the status of the "manufacturing" exemption, as it was in the 1953 Act, but this was changed retroactively only a few months later by the Act of May 24, 1956, P.L. (1955) 1707 which placed a definition of the term "manufacturing" in the law for the first time. The definition was not broad, and in the judgement of the administrators of the law, coincided with the judicial definition of the exemption in Pennsylvania:

> "The performance of manufacturing, fabricating, compounding, processing or other operations, engaged in as a business which place any personal property in a form, composition or character different from that in which it was acquired."

By 1957, however, the legislature was ready to redefine "manufacture" so as to broaden the exemption base.[21] It specified that the term was now to include packaging operations, publishing and printing, research and the performance of work for use by the manufacturer. None of these areas is within the scope of the "manufacturing" exemption under the traditional judicial definition. Furthermore, the scope of the exemption was broadened to cover not merely property which was consumed in the manufacturing process, or transferred to the buyer as an ingredient or component, but also to machinery and equipment and parts and supplies used to perform manufacturing operations, whether "consumed" or not. This constituted tremendous broadening of the exemption base, since it enabled manufacturers to claim the exemption upon all of the tools of production. It should be noted that no such treatment has been given to retailers upon their purchase of the "tools of their trade" - i.e., a store owner who purchased showcases, cash registers, etc. is required to pay the tax upon these acquisitions.

The exemption was subsequently broadened even further by adding "foundations" for machinery to the exempt list,[22] specifically excluding from tax the purchase of property which would be incorporated into the construction thereof - even though, under the general theory of sales taxation, a person incorporating property into real estate had always been deemed to be the taxable user thereof. In 1961, the exemption was again broadened by the addition of a definition of "processing", which made certain business activities which the Courts had specifically declared to be non-manufacturing activities, entitled to the exemption.[23] These businesses - including food processing, dying and finishing of fabrics, treatment of metals, preparation of animal feed, brewing, bottling soft drinks, milling and planing, meat packing, and others -

investment of time and money, sales tax administrators had succeeded in fending off efforts to erode the traditional judicial definition of manufacturing. In each case, the Court had declared that these activities were not entitled to the exemption. In addition to adding the "processing" exemption in August of 1961, the exemption was made retroactive to March 6th, 1956! It might be noted that under the law, the refund period was only eighteen momths, so that taxpayers who had complied with the law as it then was written, and had paid the tax, were only entitled to a refund for the eighteen month period immediately prior to the application, but taxpayers who had defied the law and refused to pay were given the bonus of an exemption from the tax from the beginning!

At the present time, the manufacturing exemption under the Sales Tax Act is broader than that under the Capital Stock and Franchise Tax Acts. Although the "processing" exemption was added to the Capital Stock Tax and Franchise Tax Acts in 1961, those acts still do not contain a statutory definition of the word "manufacture"; thus, the broadened definition of the term for sales tax purposes, which includes packaging, research, and similar anciliary activities, does not apply to the Capital Stock Tax and Franchise Tax. The distinction, however, is not as important as it may appear, since the exemption for the purposes of Capital Stock Tax and Franchise Taxes is not based upon specific operations, but rather upon the character of the corporation as a whole.

THE PUBLIC UTILITIES EXEMPTION

The Consumers Sales Tax Act of 1953 treated public utilities in exactly the same way as manufacturing, simply granting an exemption upon the sale of property to be used in producing public utility services and to be made an ingredient or component part of the public utility product or to be consumed in the process of producing or during public utility service.[24] As in the case of the manufacturing exemption, the original Sales and Use Tax Act of 1956 continued this relatively narrow exemption, but the Act was promptly amended so as to grant the utilities a much broader exemption.[25] First, the exemption was extended to the construction, re-construction, remodeling, repairing or maintenance of public utility facilities - including real estate except buildings. This means that in the case of public utilities, the exemption included trackage, wiring, etc. The Act was also extended to give to the utilities a special

exemption for motor vehicles,[26] for property used in maintenance of public utility real estate.[27] Thus, the utilities exemption covered everything used by a public utility including "foundations" and other real estate, except office equipment and "buildings". In addition, a special exemption was granted to the railroads under Sec. 203, the exclusions section, upon the sale at retail or use of all rail transportation equipment used in the movement of personalty.[28]

The utilities exemption has been the subject of careful legislative attention from the beginning of the act, and judicial decisions which weakened the exemption position of utilities were promptly overruled by the legislature. However, those which eroded the tax base in favor of utilities were usually permitted to stand. An excellent example is Commonwealth vs. Chas. A. McHugh.[29] This decision held that an independent contractor hired by a public utility may "borrow" the exempt status of the utility and claim the exemption upon the contractors purchase of property which will be incorporated by him into facilities which the utility will subsequently use. This decision dealt a body-blow to the so-cal led "exclusive use theory" which administrators of the Sales Tax law had been following from the beginning, and opened the door to a tremendous broadening of the originally-intended exemption pattern. It is interesting to note, however, that the newly-created exemption covered only work done by contractors for utilities, manufacturers, processors, publishers, shipbuilders and miners - that is, those operations listed in Sec. 2(j) of the Act as exempt from the definition "sale at retail" - but it did not cover the "second echelon" of exemptions - charities, broadcasting stations, governmental agencies, etc. - those listed by Sec. 203 of the Act, thus producing another example of the effect of "selectivity".

The utilities exemption follows the same pattern as that of the manufacturers' exemption. The administrators of the tax sought to establish the right of the Commonwealth to tax borderline operations and property not "directly" used in utility work, (e.g., meters used by gas companies to register the amount of gas delivered for billing purposes) - and the Commonwealth's attorneys were usually successful in court -- but invariably, these judicial decisions were nullified by amendments, usually retroactive in effect.

THE SUN SHIP EXEMPTIONS

The Consumer Sales Tax Act of 1953 contained no exemption for shipbuilding, although the Courts of Pennsylvania have always held that the construction and re-construction of ships is manufacturing under Commonwealth law, including the altering and repairing of machinery.[30] (Commonwealth vs. Delaware River Iron Shipbuilding and Engine Works, 2 Dauphin 232 (1893); Commonwealth vs. Wm. Cramp & Sons, 1 Dauphin 95 (1893); Commonwealth vs. Philadelphia Ship Repair Co., 21 Dauphin 44 (1918).) Thus, even without a separate definition, shipbuilding, repairing, rebuilding, etc. has always been considered manufacturing. However, when the 1956 Act was passed, the lobbyists for Sun Ship descended in force. The following special exemption provisions were placed in the Act:

> 1. The term "manufacture" was defined so as to include "building, rebuilding, repairing and making adjustments to, or replacements in or upon vessels designed for commercial use of registered tonnage of 50 tons or more when produced upon special order of the purchaser or when rebuilt, repaired or enlarged or when replacements are made upon or for the account of owner".
>
> 2. Section 203, the exclusion section, excluded from the tax, "Sale at retail or use of vessels designed for commercial use of registered tonnage of 50 tons or more when produced by the builders thereof by request of the purchaser.
>
> 3. Sale at retail of tangible personal property or services used or consumed in building, rebuilding, repairing or making additions to or replacements in or upon vessels designed for commercial use of registered tonnage of 50 tons or more upon special order of purchaser or when repaired, replaced or enlarged or when replacements are made upon order of or for the account of the owner;
>
> 4. The sale at retail or use of tangible personal property or services to be used or consumed for ship cleaning or maintenance, or as fuel, supplies, ships equipment, ship stores or sea stores on vessels to be operated principally outside limits of this Commonwealth.

OTHER EXEMPTIONS

Without going into their history in detail, the following additional business operations have been singled out for special exemption treatment:

1. Publishing, originally including the publishing of mail order catalogs and direct mail advertising literature, but later expanded to cover all publishing.[31]

2. Mining, originally defined as mining and quarrying of natural resources, but later expanded to include refining, and the extracting of waste materials from stock piles or banks, including blast furnace slag.[32]

3. Research, made a part of the manufacturing exemption (including all research except market research or administrative research).[33]

4. Demonstrators, with special reference to motor vehicles used by dealers as demonstrator vehicles.[34]

5. Wrapping and packaging supplies, including non-returnable containers as well as returnables.[35]

6. Fish raised in commercial hatcheries sold to fee fishing lakes.[36]

CONCLUSION

There are numerous other special treatment provisions in the law, including special tax rates for businesses moving into the State and for contractors, but the foregoing should be sufficient to demonstrate the pattern which has prevailed over the years. While the exemption status of special interest groups was constantly being improved, as noted, the tax rate was rising from 1% under the 1953 Capitol Stock Tax to 3% under the 1956 Act, to 3-1/2% in April of 1959, 4% in August, 1959, 5% in 1963 and 6% in 1967. Furthermore, while the rate was being increased, additional services were being taxed - laundry services, auto inspections, car washing and cleaning, dry cleaning, tailoring, etc. Attempts were even made on occasion to tax beer and liquor sold by the glass (although this abortive tax was swept away by a seething tide of public reaction). Every increase in the tax rate was accompanied by pious assertions that the increased tax rate was needed in order to produce income for vital Commonwealth services, while at the same time, the exemptions granted to the privileged few were being ever broadened. Even now, there are in the hopper a number of bills which would broaden the industrial and commercial tax exemptions. It is quite evident that unless the sales tax pattern which has persisted over the years is drastically changed, we shall continue to see the steady broadening of the special favored treatment given to the privileged few, at the expense of a steady increase in the tax burden laid upon the general public. Thus, a tax which is inherently retrogressive to begin with, and which is the most expensive type of tax to administer, will continue to become ever-more retrogressive and burdensome.

NOTES

1. Act of July 13, 1953, No. 86, eff. September 1, 1953.

2. Act of March 6, 1956, P.L. (1953) 1228, as amended and reenacted.

3. Commonwealth v. Rohm & Haas Co., 21 D & C 2d 738, 74 Dauph. 383, 1961.

4. Section 2(1.1) of the Act, added May 29, 1963, P.L. 49, when the Act was "converted" from its original "selective" form to its present "general" form. The change actually was meaningless, and to protect the Rohm & Haas holding, which on this occasion favored the taxpayer, the legislature obligingly added a special exemption provision for railroad cars to the exclusions section 203(y).

5. Section 2(j).

6. Section 2(n).

7. Section 2(h).

8. Section 203.

9. Section 203(f).

10. Section 2(c) and 203(v).

11. Section 203(r).

12. Section 203(h).

13. Section 2(c)(4).

14. Section 2(j).

15. Section 2(n).

16. Section 203(k), 203(l).

17. Section 102(o).

18. Regulation 262, PH Pa. State Tax Guide, Old 19, CST, para. 22, 640.

19. Ibid.

20. For a detailed analysis of the judicial definition of the manufacturing exemption in Pennsylvania, see "Manufacturers Exemption From The Pennsylvania Capital Stock and Franchise Taxes", by Samuel C. Harry, January issue of TAXES, The Tax Magazine (CCH, Inc.). (1958).

21. April 4, 1957, P.L. 34.

22. April 15, 1959, P.L. 20.

23. August 23, 1961, P.L. 1092.

24. C.S.T., supra, Sec. 102(o).

25. 1956, May 24, P.L. (1955) 1707.

26. 1957, April 4, P.L. 34; 1959, April 15, P.L. 20; 1961, August 23, P.L. 49.

27. Ibid.

28. Section 203(y).

29. 406 Pa. 566 (1962), reversing in part (1960) 76 Dau. Co. 68, 76, Dau. Co. 211.

30. Commonwealth vs. Delaware River Iron Shipbuilding and Engine Works, 2 Dauphin 232 (1893); Commonwealth vs. Wm. Cramp & Sons, 1 Dauphin 95 (1893); Commonwealth vs. Philadelphia Ship Repair Co., 21 Dauphin 44 (1918).

31. Section 2(c)(2).

32. Section 2(c)(3)

33. Section 2(c)(5).

34. Section 204(5).

35. Section 203(j).

36. Section 203(2).

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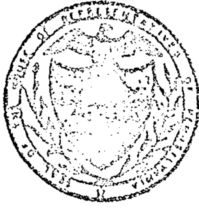

HOUSE OF REPRESENTATIVES

COMMONWEALTH OF PENNSYLVANIA

MEMO

September 22, 1970

SUBJECT: Sales Tax Regulations

TO: All Members of Tax Reform Committee

FROM: Donald W. Fox, Chairman, Sales Tax Subcommittee
by: Gerald H. Goldberg, Esquire

This memorandum supplements the memorandum of August 24, 1970, regarding which certain questions have been raised by members of the Committee.

CHOOSING A CONSISTENT APPROACH: THE EFFECT OF THE AVAILABLE OPTIONS

In dealing with the several different kinds of "production" exemptions under the Sales Tax Law, it is obviously desirable -- indeed, essential -- to take a consistent approach. This approach, generally speaking, is dictated by the treatment given the manufacturing exemption. To illustrate the point, let us briefly consider the logical effect of three approaches to the manufacturing exemption:

1.) Elimination of exemption. If we are to eliminate the manufacturing exemption altogether, exempting only that property which becomes an ingredient or component of the product, or which is entirely consumed in the production process, then this approach would result in the same treatment for the utility exemption, the mining exemption, the publishing exemption, the shipbuilding exemption, etc. The processing exemption would be totally eliminated. The mining exemption would be totally eliminated except for those tools which are "used up" or "worn out" and rendered valueless in the production process. The public utilities exemption would be virtually eliminated, since for the most part there are no components which go into the product. The "product" of a utility service is, for the most part, intangible and the charges made by the utility are primarily charges for the delivery of a service to the consumer. Although water, gas and electricity can be measured on a volumetric basis, most other utilities cannot.

2.) Redefining the manufacturing exemption, so as to apply the traditional court definition of manufacturing. This would narrow the exemption base to make it clear that only those actually engaged in the production of a new and different product would be entitled to the exemption. This kind of a change would narrow the number of people who qualify for the exemption, but, presumably, the scope of the exemption which they would be permitted would remain the

same. This kind of a change would have a minimal effect upon the other tax exemptions mentioned. The production and delivery of public utility services would not be altered in definition, and the scope of the exemption would probably not be changed. It would probably involve a restriction of the mining exemption of actual mining (eliminating the refining and reclaiming exemptions), but without exception, the effect would be slight.

3.) Keeping the board definition of the activity, but narrowing the exemption allowed. This, in other words, would still allow a great number of businesses to have the exemption -- businesses which perform operations which the courts have not traditionally included within the narrow definition, including processing, refining, etc. -- but it would narrow the scope of the exemption allowed to each of those businesses. That is, the exemption would be restricted to production machinery and equipment. It would not apply to foundations, nor to public utility meters, nor to packaging machinery and equipment. As a matter of policy, if you were to go down this road, the effect would be to give a large number of people a fairly limited exemption.

The foregoing is intended to illustrate the consequences which might follow from a choice of exemption patterns. You could, in brief, take one of three basic approaches:

A.) Restrict both the activities exemption and the property exemption within each activity;

B.) Restrict the activity exempted, but give that exempt activity a broad exemption on the property which it uses; or

C.) Apply the exemption to a large number of activities, but narrow its effect on the property affected.

Any of these three approaches would be productive of more tax revenue than the present pattern, which applies both to a large number of activities and to a very broad property exemption pattern within each activity.

THE ADVERTISING EXEMPTION

If we were to tax advertising services, the question has been asked whether the tax would apply to services performed outside the State (for instance by a New York Ad Agency), and whether it would apply to advertising media in the State.

1.) If a Pennsylvania advertiser went to New York and paid an agency to prepare television, newspaper and magazine campaigns, the result would be the same as if he ordered a set of architectural drawings from an architect, a work or art, or what have you. Theoretically, a use tax would be collectible when the company brings the "product" into Pennsylvania. Unfortunately, the contracts for actually placing the ads in the media would probably be executed in New York and in the example I am considering, the actual publishing, broadcasting, etc., would take place in New York. As a matter of law, we would have no jursidictional base to touch this sort of transaction. I would be hard put to find a legal basis for the imposition of any kind of a tax in this situation.

2.) If the advertising materials were brought into Pennsylvania in some tangible form -- that is, in printed brochures, magazine ads, advertising novelties, catalogues, etc., -- we would be able to tax the user in at the full rate, which would include the entire cost of the contract. This is what the courts have recognized to the effect that although you can't tax the thinking which goes into a legal document, a work of art, or what have you; you can tax the tangible property which results. Furthermore, you can tax the full charge, even though most of that charge may represent somebody's fee for developing the idea.

INTERIM STORAGE TAX

A number of states have a tax upon charges made for the interim storage of tangible personal property. The Pennsylvania Consumer Sales, Use and Storage Tax Act of 1951 had such a provision. It imposed a tax upon charges made by commercial warehouses, movers, etc., for the storage of merchandise.

It did not tax merchandise in inter-state commerce which was stored in Pennsylvania for an interim period, but without finally coming to rest. This is a legal concept which the Supreme Court of the United States clarified years and years ago. The doctrine is that a state may not impose a tax upon a "bale" which is in transit in the state, unless and until it finally comes to rest. Mere interim storage -- that is, a temporary stop-over while the property is in transit to another state -- does not give the state tax jurisdiction. Therefore, a company which has a warehouse for redistribution of merchandise to branch stores may not be taxed upon the storage of that merchandise if the property is ultimately redistributed to branches outside Pennsylvania. As for that property which is transferred to a branch in Pennsylvania, the tax may be imposed. However, it must be pointed out that such a tax would duplicate the sales tax collected by the retailer from the ultimate consumer since the cost of such interim storage must be deemed to be part of the cost of doing business. The other states which have gone this route have uniformly limited the tax to private storage by warehouses and storage companies and movers and have not attempted to apply it to interim storage in other areas.

THE EFFECT ON THE UTILITY EXEMPTION OF LIMITING TAX EXEMPTIONS TO PROPERTY USED ONLY IN "PRODUCTION".

When the CST was originally enacted, the utilities were given the same exemption as the manufacturers were. They were exempted only on property which was used or consumed in the production of the utility service. Subsequently, the terms "delivery or rendition" were added so that the exemption was expanded to cover property which was consumed in the "production, delivery or rendition of utility services".

These changes were made because, as indicated above, there are numerous utility services which are not "produced". Transportation services, for example, can scarcely be said to be "produced" in the sense that one produces a product. Even a water or gas company does not "produce" the water or natural gas which it pipes to the consumer -- its service consists in piping or delivering the utility service. Although electricity is "produced", it can ~~scarcely~~ be argued that the mere production of electricity would be valueless without the delivery thereof to the consumer.

Accordingly, I feel that it is amply clear that in dealing with the utilities, it may well be argued that the terms delivery or rendition are essentially to cover the intended scope of the exemption. There are two areas which are controversial, which the committee might consider:

1.) The exemption for meters. Initially, the sales tax exemption was not applied to meters, the Bureau took the position that these were mere bookkeeping or measuring devices not directly used in the production, delivery or rendering of the service. The argument to the contrary is that the rate-making process is an inherent part of the production of a utility service and that a meter is just as essential as any other part of the utilities' property.

2.) The contractor's exemption. Under the McHugh decision, the court held that the exemption granted to utilities for property used directly in utility services may be extended to the purchase by a contractor of property which the contractor will use in building utility facilities. This exemption was subsequently extended even further to cover all property purchased by a contractor which, if purchased by the ultimate user, would be exempted. Thus, the "McHugh" exemption became a secondary exemption, a sort of "laying on of hands" in which the exemption status of the consumer is assumed by the contractor. We have suggested that this exemption would be generally removed.

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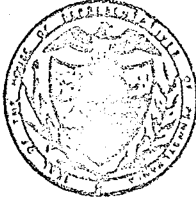

HOUSE OF REPRESENTATIVES
COMMONWEALTH OF PENNSYLVANIA

MEMO

October 13, 1970

SUBJECT: Shipping and Interstate Commerce Exemption - Sales Tax Law

TO: All Members of the Tax Reform Committee

FROM: Donald W. Fox, Chairman
Sales Tax Subcommittee

BY: Gerald H. Goldberg
Assistant Legal Counsel

At our last meeting, the staff presented its suggestions regarding the ship building exemption, and the Committee discussed the sales and use tax exemptions regarding property acquired for shipment outside the Commonwealth or for incorporation into other property to be shipped outside the Commonwealth. This memorandum sets forth the provisions agreed to with respect to ship building, and staff's recommendations regarding the interstate commerce exemption.

A. Ship Building. It was agreed that the ship building exemption ought to be made consistent with the exemption granted by nearby states which compete with Pennsylvania in this market.

The Maryland sales tax law exempts the sale of new or used vessels where (1) an excise tax otherwise provided in Maryland law has been paid, or (2) the vessel has been titled in another state. There are no specific exemptions for the building, rebuilding, repair or maintenance of ships. However, under Maryland law, ingredients incorporated into manufactured articles would be exempt. Our proposal is to follow this pattern.

With respect to fuel, provisions, ship's stores and supplies, it is proposed to exempt these items if they are purchased for predominant use in interstate or foreign commerce; however, we would follow the sales tax provisions of New York and New Jersey, which would tax these items when they are purchased for the equiping of a new ship, and go to the owner as part of the "package."

B. Richard H. Wagner lead a discussion regarding Sections 2 N and 2 H of the Sales Tax Act, which exempts from the definition of "sale at retail" and "use" property which is acquired for the purpose of transporting it outside the Commonwealth as is, or as an ingredient of other property which will be transported outside the Commonwealth.

This exclusion, which is broader than that found in any other state sales tax act that we have examined, constitutes a substantial loophole. It enables corporations to use Pennsylvania as a storage or warehousing state, without subjecting themselves to the inventory or personal property tax, and without having to pay a sales tax. Theoretically, any portion of property originally acquired for shipment to other states which is taken out of the shipment and used in Pennsylvania would become subject to a use tax. However, it was pointed out that this tax cannot be collected except upon voluntary declaration or audit.

Mr. Wagner and I have concluded that the several problems involved in this area, including the problem of use tax involvement, tax avoidance devices and relationships with other states, can best be resolved in the following manner:

1. Eliminate the language in Sections 2 H and 2 N excluding property in interstate and foreign commerce, and leave the matter of such exclusion to the "silent" exclusion of the Federal Consitution. It might be wise to simply say, "The tax shall not apply to property in interstate or foreign commerce." This is the approach which the old CST used, and which most of the other states use. This would mean that the exemption would be limited to the well defined but narrow field of exclusion established by case law. We might point out that there need be no ambiguity or difficulty with this proposal, since the scope of the interstate commerce exemption is one of the clearest and best defined areas in the law.

2. We propose that specific language be added to the act authorizing the Department of Revenue (the Commonwealth) to enter into compacts with other states for the collection of sales and use taxes of those states on a reciprocal basis. Although there is general compact language in the present act, in our judgment it does not extend to the actual collection of the taxes of other states on a reciprocal basis. There is a proposal before the Multi-State Tax Commission which would, if finally enacted, create a federal interstate sales and use tax collection system whereby the state of origin would, in every case, collect the tax, and re-distribute it to the state of destination in due course. Whether such a compact is ever enacted or not, we ought to have enabling language. But we ought not to restrict ourselves to any specific tax collection plan. It might be noted that such language will help to alleviate the qualms some persons may have regarding the possible inequities which may be created by the strict enforcement of the interstate commerce exclusion. Of course, even in the absence of such a compact provision, we already have reciprocal tax credit provisions which would ac-complish substantially the same result.

3. In addition to the foregoing, Mr. Wagner and I feel that the use tax reporting and collection provisions can and should be strengthened. It is our feeling that much more can be done in the area of enforcing the use tax provisions of the law. Specifically, we would like to see:

a) A requirement that the resale exemption be merely presumptive unless and until the person claiming said exemption reports the actual resale to the Commonwealth. Of course, such a requirement will have to be tailored to situations in which small ticket items are sold in huge amounts at retail. Perhaps it might be sufficient, with respect to retail sales, to simply require the seller claiming the resale exemption to report a sale to a Pennsylvania retailor. We think that this sort of reporting requirement could help plug up one use tax loophole.

b) We ought to give some thought to requiring stiffer criminal and civil penalties for evasion of the use tax, perhaps including a provision that property upon which the use tax has not been paid may be deemed contraband subject to confiscation. Further, we ought to make more use of the bonding provisions under the Sales Tax Act with respect to businesses which have been found, by audit, to be evading or attempting to evade, use tax liabilities. Any business which has been caught evading use tax liabilities ought to be routinely bonded, and the bond ought to be a substantial one.

c) We ought to write some language into the "arms length transaction" provisions of the Act, establishing a presumption with respect to subsidiary or controlled corporations which sell to parent or affiliated corporations. Such transactions ought to be presumed subject to the arms length rule, and we ought to place the burden of establishing a legitimate business purpose upon the taxpayer.

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Comparison of Loss in Sales Tax Revenue With Additional Yield from Expansion of Tax Base for Tax Rate Reductions of 1%, 2% and 3%

Estimated Fiscal Year 1970-71

			($ millions)	
Loss in Sales Tax Revenue if Tax Rate is Reduced by:				
1%		$166.0		
2%			$332.0	
3%				$498.0
Additional Yield at:	1%	5%	4%	3%
(1) If present exemptions (except food and clothing) are eliminated:		154.0	123.2	92.4
Coal	2.8	14.0	11.2	8.4
Periodicals and publications including newspapers	1.8	9.0	7.2	5.4
Value of property taken in trade	6.2	31.0	24.8	18.6
Machinery, equipment and supplies used or consumed in manufacturing a/, processing, utilities and mining	20.0	100.0	80.0	60.0
(2) If tax is extended to services b/ not presently taxed:	18.2	91.0	72.8	54.6
(3) If food and clothing exemptions are eliminated:				
Food	39.5	197.5	158.0	118.5
Clothing	20.5	102.5	82.0	61.5

a/ Includes shipbuilding

b/ Does not include tax on storage charges, intrastate transportation services, and professional services (doctors, lawyers, veterinarians, architects, accountants).

PERSONAL INCOME TAX

The Committee recommends that there be enacted a personal income tax to be levied at a uniform rate upon net taxable income (gross income less deductions and exemptions) as defined for federal tax purposes with a vanishing tax credit.

Since 1950, State and local expenditures for essential governmental services have been accelerating at an annual rate of 8 to 9% which has been much in excess of the rate of growth of State and local government revenues. The funds needed to finance these services have for the most part been provided in the past by reliance upon regressive general retail sales and property taxes with all of the attendant hardships inherent in such taxes on the fixed low and moderate income families. This existing tax structure has not only been inequitable in terms of the distribution of its impact, but has failed to keep pace with the rising costs of necessary governmental functions. Revenues from the general retail sales and property taxes have increased at only about 1/2 the rate of growth of government spending at the State and local governmental level and roughly in proportion to the gross national product.

The Committee therefore recognizes that prevailing considerations of tax equity and fairness and the inadequacy of the existing revenue structure necessitates the adoption in the Commonwealth of Pennsylvania of a state personal income tax. Almost every other State in the Nation has similarly responded to the call for change in regressive imposts and which do not generate adequate income to allow government to administer to the imperative needs of its people. As of the date of this report 41 other states have enacted State personal income tax laws.

Many other additional considerations were the subject of the Committee's deliberation and which motivated the Committee to make this recommendation. One such consideration is the revenue responsiveness of an income tax system to economic prosperity, commonly referred to as gross national product elasticity. When the economic climate is good and the economy is growing, collections from income taxes, unlike those from most other consumer taxes, increase at a faster rate than does the gross national product. This occurs because when personal income increases, previously non-taxable persons are shifted into taxable categories adding to the collective growth of revenue income. Recent experiences in other States demonstrate that a 10% increase in economic activity automatically increases State income tax collections by 15 to 18%. This obviates the need for accelerating tax rate increases and nevertheless provides additional revenue to meet expanding demands for essential services upon State government.

Although the Pennsylvania State Constitution with its existing proscription against a graduated tax precludes a full implementation of a tax system that seeks to impose taxes in accordance with ability to pay, the State personal income tax nevertheless would allow for the introduction of substantial considerations that will help reverse the trend of regression that presently exist. Such considerations include the relating of tax liability not only to the taxpayers' income, but also to family size, costs incurred in acquiring business income, and those other personal demands on income including, but not limited to, tax and interest payments, charitable contributions, medical expenses, etc.

In addition, an income tax system usually results in a more equal treatment of individuals and households with equal income, a consideration which grows in importance

as the margin between people's incomes and their consumer expenditures widen. The personal income tax also provides the most effective way to give tax relief to the disadvantaged members of our society -- the impoverished. The Committee believes that the universality and dominance of the Federal income tax law has prompted most income tax states to conform their own State income tax laws to the Federal Internal Revenue Code in the interest of minimizing taxpayer inconvenience and administrative costs. The administration of a State personal income tax is simplified and its collectibility enhanced by conforming its base to that reported on Federal tax returns and by utilizing the withholding and estimated payment procedures similar to those required for Federal taxes. It is estimated that the annual yield from such a tax based upon estimated 1970 taxable income figures would approximate $233,700,000.00 for each 1% of tax.

The definition of taxable income derived from the Federal Internal Revenue Code lends itself uniquely to Federal - State income tax conformity. Because this aspect of Federal tax law is already quite explicit, the reliance upon a separate definition of taxable income would inevitably result in taxpayer inconvenience and administrative difficulty. The Committee therefore recommends that the Commonwealth of Pennsylvania adopt the Federal definition of taxable income as the most equitable tax base upon which to predicate its own income tax system.

Aside from the special treatment of income from Federal governmental obligations required by the doctrine of intergovernmental tax immunities and the interest received by a taxpayer from any obligation of a State other than Pennsylvania, the taxable income portion of most taxpayers for the income tax returns could be completed by reference to a single figure on the taxpayer's federal income tax return.

To facilitate the adoption of a State income tax law conforming in all essential respects to appropriate Federal Internal Revenue Code provisions, this Committee recommends that the legislation incorporate in one comprehensive act the provisions necessary to deal consistently with partnerships, estates, trusts, beneficiaries and decedents, as well as individuals. It should also contain a provision for crediting residents of the State for payment of income taxes to other States on income earned in such other States. This is a practice now followed by 2/3 of the income tax states in the interest of consistency with tax collection at the source and the avoidance of double taxation of the same income.

In making the above recommendation for the imposition of a State personal income tax, the Committee has carefully considered and was sensitive to constitutional limitations and judicial precedents relating to the imposition of a progressive form of income tax in Pennsylvania. It is the considered opinion of the Committee, although by no means regarded as a legal certainty, that a flat rate type of income tax predicated upon taxable income as reported to and ascertained by the Federal government most nearly meets the Pennsylvania Constitutional standard of uniformity and minimizes insofar as possible the chance of a successful court attack directed towards the constitutionality of such a tax. The judicial history of court decisions interpreting the constitution's uniformity clause as applied to various income tax proposals was reviewed. Such decisions have not established any court precedent on the issue of whether the uniformity requirements preclude the imposition of a State flat rate income tax on Federal taxable income. Although not comparable in all respects, the State's corporate net income tax which is levied at a uniform rate on Federal taxable corporate income, has been upheld by the Pennsylvania Supreme Court as not being violative of our constitutional requirement of uniformity. It should also

be noted that other states having identical constitutional uniformity restrictions have legally imposed personal net income taxes on taxable net income and such levies have been upheld by the courts of such states.

Hence the Committee recommends that the tax be imposed at a uniform rate upon taxable income as defined for Federal tax purposes and as reported on line 50 of page 2 the 1970 Federal Income Tax Form 1040. This will include taxable income from all sources including unincorporated businesses and professions adjusted to exclude any income which the states cannot tax under Federal laws (e.g., interest on Federal securities) and permitting the same personal exemptions and itemized deductions from adjusted gross income in determining taxable income as are now allowed by Federal law.

The Committee has also carefully considered the recent constitutional amendment in making its recommendations for poverty deductions and exemptions. When the Constitutional Convention of 1967 considered the matter of taxation, it added new provisions to the Constitution. The Convention adopted Article VIII, Section 2 (b) (ii) which provided, in part, as follows: "Establish as a class or classes of subjects of taxation the property or privileges of persons who, because of age, disability, infirmity or poverty are determined to be in need of tax exemption or of special tax provisions, and for any such class or classes, uniform standards and qualifications. The Commonwealth, or any other taxing authority, may adopt or employ such class or classes and standards and qualifications, and except as herein provided may impose taxes, grant exemptions, or make special tax provisions in accordance therewith. No exemption or special provision shall be made under this clause with respect to taxes upon the sale or use of personal property, and no exemption

from any tax upon real property shall be granted by the General Assembly under this clause unless the General Assembly shall provide for the reimbursement of local taxing authorities by or through the Commonwealth for revenue losses occasioned by such exemption."

This new constitutional amendment has modified the rigidity of the uniformity clause with respect to the taxation of individuals in connection with the matter of age, disability, infirmity or poverty. The Committee believes that the language of the constitutional amendment parallels the Federal definitions for determining exemptions and is aware that the Internal Revenue Code allows additional exemptions both for blind persons and persons 65 years of age or older.

The Committee carefully considered the feasibility of a tax credit system which would provide tax relief for low and moderate income persons on the basis of age, disability, infirmity or poverty.

The Committee concluded that tax credits can be employed instead of deductions or additional exemptions to adjust the tax burden for an individual in order to alleviate the regressive aspects of a flat rate income tax system. A system of tax credits is a more effective and meaningful method of introducing equity into Pennsylvania's tax structure than is a system predicated upon deductions from gross income. The credit is a straight subtraction from tax liability; the deduction merely reduces the amount to which the tax rate is to be applied.

The Committee studied the various poverty levels of income as presently established and gave serious consideration to the following information relative to poverty and near poverty levels of existence:

1. Welfare Reform Bill (H.R. 16311 - pages 28 - 29) which disclosed a poverty level of $3,728 for a nonfarm family of four persons.

2. Poverty in the U.S., published by the U.S. Census based poverty levels on the Department of Agriculture's emergency food budget and established a poverty level for a nonfarm family of four as being $3,553.

3. Social Security Administration defined near poverty as being approximately one-third higher than the poverty level.

4. Economic Report of the President, January, 1969, was interpreted to show a poverty level of $3,728 and a near poverty level of $4,857.

5. Bureau of Labor Statistics has developed a low sample budget before taxes for an urban family of four which for the spring of 1969 was $6,567. The following are the estimates for three Pennsylvania cities: Philadelphia $6,628; Pittsburgh $6,487; and Lancaster $6,445.

After thorough consideration of the data presented regarding poverty and near poverty levels, the Committee concluded in light of existing revenue needs in the Commonwealth of Pennsylvania that the poverty level for a family of four in the Commonwealth of Pennsylvania should be established at approximately $5,600. This would equate to a net taxable income level as established for federal tax purposes at $2,500.

This level further reflects the delineation of those incomes that fall within a characterization of near poverty level. The Committee also decided that tax credits should be available on a diminishing basis to a family of four, for the taxable Federal net income level ranges between $2,500 and $5,000. Any family of four having a federal net taxable income of $5,000 which would roughly approximate $8,300 in gross income, would thus not have the benefit of any tax credit. At this point the tax credit would vanish. The Committee

recommends that the above-described vanishing tax credit be allowed against the State income tax liability in order to offset the regressivity of a flat tax rate on low and moderate income families.

A schedule showing the vanishing State tax credit available to low and near poverty level taxpayers is included in the report as Exhibit A. An analysis of the schedule shows that the amount of the tax credit is simply based on two variable factors; viz., exemptions and taxable income.

For example, assuming a tax rate of two percent (2%) of federal taxable income, a person who has a taxable income of $3,400 and five exemptions would tentatively owe sixty-eight (68) dollars in tax before the application of the tax credit of fifty-seven and one-half (57.50) dollars which, when subtracted would result in his actual state tax liability of ten and one-half (10.50) dollars.

The Committee also considered several plans relating to tax relief for senior citizens with fixed low incomes. The Committee decided that the plans which were discussed lacked the basic equity and relief which was desired in this area. Consequently, the Committee has made no final recommendation regarding this problem other than the adoption of House Bill No. 103 of the 1969 Session. Further, the Committee strongly urges that additional research and study be conducted in order to develop a feasible plan which would include equitable tax relief for all senior citizens of limited income.

The Committee, however, does recognize that our senior citizens are, at least, receiving partial relief from the recommended state income tax because additional exemptions for persons sixty-five years of age or older are deducted from federal gross income in determining net taxable income and, in addition, the vanishing tax credit takes into consideration the number of exemptions, including exemptions based on age and blindness, in determining the amount of the credit.

While we have taken note of the pattern of progressive income taxation in the other states with respect to both earned and unearned income, and although court decisions from other states approved progressive graduated income taxes which were challenged under State constitutional "uniformity clauses" identical with that in the Pennsylvania Constitution, this Committee recommends at this time adoption of a single rate income tax with equitable exemptions based on income level and dependency. We have taken this course because, in our opinion, such tax can best withstand legal assault. However, we recommend that the Legislature act without delay to remove any legal impediment to the enactment of a graduated income tax by placing before the electorate a proposed amendment to the Constitution. If, in the wisdom of any future legislative body, a graduated tax system best serves the cause of equitable taxation, that legislative body should be free to enact legislation to effectuate the same.

EXHIBIT A

VANISHING TAX CREDIT

Net Taxable Income	Tax at 1%	Number of Exemptions											
		1	2	3	4	5	6	7	8	9	10	11	12
$100	$1	$ 1.00	$ 1.00	$ 1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00
200	2	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
300	3	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
400	4	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
500	5	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
600	6	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
700	7	6.25	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00	7.00
800	8	6.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
900	9	5.75	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00
1000	10	5.50	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00
1100	11	5.25	11.00	11.00	11.00	11.00	11.00	11.00	11.00	11.00	11.00	11.00	11.00
1200	12	5.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00
1300	13	4.75	12.50	13.00	13.00	13.00	13.00	13.00	13.00	13.00	13.00	13.00	13.00
1400	14	4.50	12.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00
1500	15	4.25	11.50	15.00	15.00	15.00	15.00	15.00	15.00	15.00	15.00	15.00	15.00
1600	16	4.00	11.00	16.00	16.00	16.00	16.00	16.00	16.00	16.00	16.00	16.00	16.00
1700	17	3.75	10.50	17.00	17.00	17.00	17.00	17.00	17.00	17.00	17.00	17.00	17.00
1800	18	3.50	10.00	18.00	18.00	18.00	18.00	18.00	18.00	18.00	18.00	18.00	18.00
1900	19	3.25	9.50	18.75	19.00	19.00	19.00	19.00	19.00	19.00	19.99	19.00	19.00
2000	20	3.00	9.00	18.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00	20.00
2100	21	2.75	8.50	17.25	21.00	21.00	21.00	21.00	21.00	21.00	21.00	21.00	21.00
2200	22	2.50	8.00	16.50	22.00	22.00	22.00	22.00	22.00	22.00	22.00	22.00	22.00
2300	23	2.25	7.50	15.75	23.00	23.00	23.00	23.00	23.00	23.00	23.00	23.00	23.00
2400	24	2.00	7.00	15.00	24.00	24.00	24.00	24.00	24.00	24.00	24.00	24.00	24.00
2500	25	1.75	6.50	14.25	25.00	25.00	25.00	25.00	25.00	25.00	25.00	25.00	25.00
2600	26	1.50	6.00	13.50	24.00	26.00	26.00	26.00	26.00	26.00	26.00	26.00	26.00
2700	27	1.25	5.50	12.75	23.00	27.00	27.00	27.00	27.00	27.00	27.00	27.00	27.00
2800	28	1.00	5.00	12.00	22.00	28.00	28.00	28.00	28.00	28.00	28.00	28.00	28.00
2900	29	.75	4.50	11.25	21.00	29.00	29.00	29.00	29.00	29.00	29.00	29.00	29.00
3000	30	.50	4.00	10.50	20.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00

Line indicates point at which there is no tax liability.

EXHIBIT A

VANISHING TAX CREDIT

Taxable Income	Tax at 1%	Number of Exemptions 1	2	3	4	5	6	7	8	9	10	11	12
$3100	$ 31	$ .25	$ 3.50	$ 9.75	$ 19.00	$ 31.00	$ 31.00	$ 31.00	$31.00	$ 31.00	$ 31.00	$ 31.00	$ 31.00
3200	32	.00	3.00	9.00	18.00	31.25	32.00	32.00	32.00	32.00	32.00	32.00	32.00
3300	33	.00	2.50	8.25	17.00	30.00	33.00	33.00	33.00	33.00	33.00	33.00	33.00
3400	34	.00	2.00	7.50	16.00	28.75	34.00	34.00	34.00	34.00	34.00	34.00	34.00
3500	35	.00	1.50	6.75	15.00	27.50	35.00	35.00	35.00	35.00	35.00	35.00	35.00
3600	36	.00	1.00	6.00	14.00	26.25	36.00	36.00	36.00	36.00	36.00	36.00	36.00
3700	37	.00	.50	5.25	13.00	25.00	37.00	37.00	37.00	37.00	37.00	37.00	37.00
3800	38	.00	.00	4.50	12.00	23.75	37.50	38.00	38.00	38.00	38.00	38.00	38.00
3900	39	.00	.00	3.75	11.00	22.50	36.00	39.00	39.00	39.00	39.00	39.00	39.00
4000	40	.00	.00	3.00	10.00	21.25	34.50	40.00	40.00	40.00	40.00	40.00	40.00
4100	41	.00	.00	2.25	9.00	20.00	33.00	41.00	41.00	41.00	41.00	41.00	41.00
4200	42	.00	.00	1.50	8.00	18.75	31.50	42.00	42.00	42.00	42.00	42.00	42.00
4300	43	.00	.00	.75	7.00	17.50	30.00	43.00	43.00	43.00	43.00	43.00	43.00
4400	44	.00	.00	.00	6.00	16.25	28.50	43.75	44.00	44.00	44.00	44.00	44.00
4500	45	.00	.00	.00	5.00	15.00	27.00	42.00	45.00	45.00	45.00	45.00	45.00
4600	46	.00	.00	.00	4.00	13.75	25.50	40.25	46.00	46.00	46.00	46.00	46.00
4700	47	.00	.00	.00	3.00	12.50	24.00	38.50	47.00	47.00	47.00	47.00	47.00
4800	48	.00	.00	.00	2.00	11.25	22.50	36.75	48.00	48.00	48.00	48.00	48.00
4900	49	.00	.00	.00	1.00	10.00	21.00	35.00	49.00	49.00	49.00	49.00	49.00
5000	50	.00	.00	.00	.00	8.75	19.50	33.25	50.00	50.00	50.00	50.00	50.00
5100	51	.00	.00	.00	.00	7.50	18.00	31.50	48.00	51.00	51.00	51.00	51.00
5200	52	.00	.00	.00	.00	6.25	16.50	29.75	46.00	52.00	52.00	52.00	52.00
5300	53	.00	.00	.00	.00	5.00	15.00	28.00	44.00	53.00	53.00	53.00	53.00
5400	54	.00	.00	.00	.00	3.75	13.50	26.25	42.00	54.00	54.00	54.00	54.00
5500	55	.00	.00	.00	.00	2.50	12.00	24.50	40.00	55.00	55.00	55.00	55.00
5600	56	.00	.00	.00	.00	1.25	10.50	22.75	38.00	56.00	56.00	56.00	56.00
5700	57	.00	.00	.00	.00	.00	9.00	21.00	36.00	56.25	57.00	57.00	57.00
5800	58	.00	.00	.00	.00	.00	7.50	19.25	34.00	54.00	58.00	58.00	58.00
5900	59	.00	.00	.00	.00	.00	6.00	17.50	32.00	51.75	59.00	59.00	59.00

Line indicates point at which there is no tax liability.

EXHIBIT A
VANISHING TAX CREDIT

Net axable ncome	Tax at 1%	Number of :xemptions 1	2	3	4	5	6	7	8	9	10	11	12
6000	$ 60	$.00	$.00	$.00	$.00	$.00	$ 4.50	$ 15.75	$ 30.00	$ 49.50	$ 60.00	$60.00	$60.00
6100	61	.00	.00	.00	.00	.00	3.00	14.00	28.00	47.25	61.00	61.00	61.00
6200	62	.00	.00	.00	.00	.00	1.50	12.25	26.00	45.00	62.00	$ 62.00	62.00
6300	63	.00	.00	.00	.00	.00	.00	10.50	24.00	42.75	62.50	63.00	63.00
6400	64	.00	.00	.00	.00	.00	.00	8.75	22.00	40.50	60.00	64.00	64.00
6500	65	.00	.00	.00	.00	.00	.00	7.00	20.00	38.25	57.50	65.00	65.00
6600	66	.00	.00	.00	.00	.00	.00	5.25	18.00	36.00	55.00	66.00	66.00
6700	67	.00	.00	.00	.00	.00	.00	3.50	16.00	33.75	52.50	67.00	67.00
6800	68	.00	.00	.00	.00	.00	.00	1.75	14.00	31.50	50.00	68.00	68.00
6900	69	.00	.00	.00	.00	.00	.00	.00	12.00	29.25	47.50	68.75	69.00
7000	70	.00	.00	.00	.00	.00	.00	.00	10.00	27.00	45.00	66.00	$ 70.00
7100	71	.00	.00	.00	.00	.00	.00	.00	8.00	24.75	42.50	63.25	71.00
7200	72	.00	.00	.00	.00	.00	.00	.00	6.00	22.50	40.00	60.50	72.00
7300	73	.00	.00	.00	.00	.00	.00	.00	4.00	20.25	37.50	57.75	73.00
7400	74	.00	.00	.00	.00	.00	.00	.00	2.00	18.00	35.00	55.00	74.00
7500	75	.00	.00	.00	.00	.00	.00	.00	.00	15.75	32.50	52.25	75.00
7600	76	.00	.00	.00	.00	.00	.00	.00	.00	13.50	30.00	49.50	72.00
7700	77	.00	.00	.00	.00	.00	.00	.00	.00	11.25	27.50	46.75	69.00
7800	78	.00	.00	.00	.00	.00	.00	.00	.00	9.00	25.00	44.00	66.00
7900	79	.00	.00	.00	.00	.00	.00	.00	.00	6.75	22.50	41.25	63.00
8000	80	.00	.00	.00	.00	.00	.00	.00	.00	4.50	20.00	38.50	60.00
8100	81	.00	.00	.00	.00	.00	.00	.00	.00	2.25	17.50	35.75	57.00
8200	82	.00	.00	.00	.00	.00	.00	.00	.00	.00	15.00	33.00	54.00
8300	83	.00	.00	.00	.00	.00	.00	.00	.00	.00	12.50	30.25	51.00
8400	84	.00	.00	.00	.00	.00	.00	.00	.00	.00	10.00	27.50	48.00
8500	85	.00	.00	.00	.00	.00	.00	.00	.00	.00	7.50	24.75	45.00
8600	86	.00	.00	.00	.00	.00	.00	.00	.00	.00	5.00	22.00	42.00
8700	87	.00	.00	.00	.00	.00	.00	.00	.00	.00	2.50	19.25	39.00
8800	88	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	16.50	36.00
8900	89	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	13.75	33.00

Line indicates point at which there is no tax liability.

EXHIBIT A
VANISHING TAX CREDIT

Net Taxable Income	Tax at 1%	Number of Exemptions											
		1	2	3	4	5	6	7	8	9	10	11	12
$9000	$ 90	$.00	$.00	$.00	$.00	$.00	$.00	$.00	$.00	$.00	$.00	$ 11.00	$ 30.00
9100	91	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	8.25	27.00
9200	92	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	5.50	24.00
9300	93	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	2.75	21.00
9400	94	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	18.00
9500	95	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	15.00
9600	96	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	12.00
9700	97	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	9.00
9800	98	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	6.00
9900	99	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	3.00
10000	100	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00	.00

LOCAL GOVERNMENT TAXATION

CONTENTS

I. Availability and Use of Local Taxes

II. Findings

III. Recommendations

INTRODUCTION

This portion of the report of the Speakers Committee on Tax Reform that concerns local taxation deals only with "non-real estate" taxes. Real estate taxes have been studied separately by a Special House Committee on Local Realty Tax Administration and Exemptions.

In addressing itself to local taxation, the Committee is aware of numerous problems and complaints, on the part both of local taxpayers and taxing jurisdictions. These include the following:

- The inability of some local governments to meet their fiscal requirements.
- The regressive characteristic of local tax structures generally.
- The numerous local non-property taxes referred to as "nuisance" taxes.
- Fragmented and inefficient tax collection organizations and procedures.

During the course of its deliberations the Committee has discussed tax problems with representatives of local governments and had the use of a Pennsylvania Economy League study "Non-Real Estate Taxes" September 1969, from which were abstracted the statistical data contained in this report.

I. LOCAL TAX SOURCES AND THEIR USE

Far-reaching tax enabling legislation applicable to almost all political subdivisions in Pennsylvania has given the local governments (other than counties) and the school districts in the Commonwealth a broad range of non-real estate tax sources - greater local taxing authority than is granted in most other states. The only significant local revenue producer found in some other states but not in Pennsylvania is the sales tax. The taxes most commonly in use are listed below:

- Earned income or wage
- Per capita
- Occupation
- Occupational privilege
- Mercantile or gross receipts
- Personal property
- Real estate transfer
- Amusement
- Mechanical devices

The statutory sources of local taxing power are of four significant kinds. The first is the respective codes of law applicable to counties, to municipalities and to school districts. The second source is separate legislation establishing the personal property tax in counties.

The last two sources of taxing authority are the general tax enabling acts. The Sterling Act, enacted in 1932, is applicable to the city of Philadelphia. Act 511 of 1965 is applicable to other classes of political subdivisions in the Commonwealth except counties and except the Philadelphia and Pittsburgh school districts, and is a direct successor to the pioneer of such acts, Act 481 of 1947. The kinds of taxes available to all local subdivisions and the enabling acts are discussed in more detail in succeeding paragraphs.

Taxes Authorized by Local Codes or Other Laws

Per Capita Taxes

A per capita tax is a flat rate tax levied upon each adult within the taxing district. The tax has no connection with employment, income, voting rights or any other factor except residence within the community. The tax is

authorized in the codes of law for second through fourth class school districts, for third class cities (referred to as a residence tax), and for fourth to eighth class counties as an alternative to the occupation tax; all of the foregoing at a maximum rate of $5. Pittsburgh is authorized to levy a $1 poll tax which, however, also has no reference to voting rights. Those political subdivisions under the authority of Act 511, the local Tax Enabling Act, may levy an additional per capita tax at a maximum rate of $10. Where a coterminous municipality and school district wish to levy the same tax, the maximum rate must be shared between them, as is the case with other Act 511 taxes.

Occupation Taxes

The occupation tax most commonly is levied at a millage rate applied to an assessed value placed on the occupations of persons, including housewives. The assessing of the value of occupations is done by county assessing authorities. This tax has a long history, far predating that of the income tax. Historically the tax had the objective of extending the tax burden to non-farmers whether or not they owned land, as well as of relating the tax to the earning power of the individual. However, at the present time, although there is a range in the occupation assessments intended to reflect to some extent the differential in earning power among different types and levels of occupation, the valuations themselves bear no relationship to the potential earning power of individuals in these occupations and in some counties there is a flat rate assessment.

The occupation tax is authorized in the codes of laws for fourth to eighth class counties, for cities, boroughs, and for first and second class townships. The maximum rate is the same as that for the real estate tax and in some cases the individual tax ordinance must state the same rate for both taxes. Act 511 makes it possible to impose the occupation tax without any limits on the millage rate. It may also be imposed as a flat rate tax in which case there is a $10 limit. This authority has been used, particularly by

school districts, to impose taxes with rates set extremely high in order to compensate for low valuations and to produce significant tax yields. There are tax rates on record as high as 11 hundred mills (110 percent). School districts have sought to do their own assessing for this tax but have been ruled by the courts to be without statutory authority.

Mercantile or Gross Receipts Taxes

Mercantile taxes are imposed on the gross receipts of wholesale and retail businesses. A gross receipts or business privilege tax is similar but broader in application in that it is levied against the gross receipts of all who do business within the taxing jurisdiction.

The two big city school districts are authorized by the school code to levy such taxes. In the Philadelphia school district it is a gross receipts tax subject to a limit of two mills (the taxpayer may elect to pay at a rate of two percent on net income). In the Pittsburgh school district it is a mercantile tax but also includes amusement and recreation businesses and is subject to a rate limit of ½ mill on wholesale business and one mill on retail business. Mercantile taxes may be imposed under the authority of Act 511 subject to a limit of one mill wholesale and 1½ mills retail except in the city of Pittsburgh where the limits respectively are one mill and two mills. Gross receipts or business privilege taxes may also be imposed under Act 511 and are not subject to any rate limits where applied to non-mercantile businesses. Philadelphia may levy a mercantile license tax under the authority of the Sterling Act and is subject to no rate limits.

Personal Property Tax

Counties in Pennsylvania and cities coterminous with counties (Philadelphia) are authorized to levy a tax on intangible personal property at a statutory rate of four mills. The tax applies to mortgages; other interest bearing obligations and accounts; public loans except those of the United States,

the Commonwealth or political subdivisions; corporate loans not subject to the corporate loans tax; shares of stock other than those subject to the capital stock or the bank shares taxes. The Pittsburgh School District levies a personal property tax at the same rate under authority granted it by the school code. The Philadelphia School District levies a tax on unearned income. The city of Pittsburgh has special authority under Act 511 to levy a personal property tax without any designated rate limit. The rate currently is four mills.

Other Taxes

Second and third class cities are authorized in their respective codes to levy so-called license taxes. In the case of Pittsburgh there is no limit on the tax rate or amount, but third class cities are subject to a limit of $100.

The Philadelphia School District, under special legislation, is able to impose a tax of two percent on the proceeds from parimutuel wagering. This tax applies to harness and flat track racing operating within the city limits.

A 1963 Act (P.L. 640) vested in the Philadelphia City Council the authority to authorize the city school district to impose taxes on "persons, transactions, occupations, privileges, subjects and real and personal property" that are taxable by the city but with the specific exclusion of any taxes on the income of non-residents.

Act 244 of 1967 further permitted the Philadelphia City Council to authorize the city school district to tax the income from "ownership, lease, sale or other disposition of tangible and intangible real and personal property" of school district residents at a rate not to exceed that of the city earned income tax (then 2%). Excluded from such tax would be interest from government obligations and from bank or building and loan deposits, and capital gains from sale of property owned for more than six months.

Act 16 of 1969 authorized the Philadelphia City Council to permit the school district to impose a corporate net income at a three percent rate which could be increased to 4½ percent July 1, 1972. If the tax remains in effect after that date it must replace the present general business gross receipts tax.

The Sterling Act

By far the most extensive grant of taxing power to any political subdivision in the Commonwealth, and the earliest of this type, is that conveyed to the city of Philadelphia by the Sterling Act of 1932 (53 P.S. 15971). This act gives a first class city the authority "to levy, assess and collect...such taxes on persons, transactions, occupations, privileges, subjects and personal property...as it shall determine..." with the limitation that the city may not levy or collect a tax on any privilege, transaction, subject, etc. which is not or may hereafter become subject to a state tax or license fee. Subject only to the foregoing, there are no limits on the kinds of taxes which Philadelphia may impose, on the rates at which those taxes may be collected nor on the aggregate amount that may thus be raised.

Under the broad authority of the Sterling Act, Philadelphia may enact taxes on such items as wages, earnings and net profits, mercantile licenses, amusements, real estate transfers, parking lots, coin operated machines, bowling alleys, and auctioneers. The income tax imposed by the city under this act applies not only to residents of the city wherever they may work, but also to non-residents of the city who receive salaries, wages or other compensation in the city or who conduct professions or unincorporated business in the city.

The "Tax Anything" Law

Comprehensive taxing authority equivalent to that of the Sterling Act was extended to other political subdivisions in the Commonwealth by Act 481 of 1947. As originally enacted it applied to all school districts except those in Philadelphia and Pittsburgh, to all cities except Philadelphia, and to all boroughs and first class townships. Excluded were all counties and all second class townships. The latter were brought under the act in stages several years later. The original act excluded from local taxing power subjects or objects of taxation that already were or might become subject to taxation by the state, but otherwise had few exclusions. It contained no limits on the rates of specific taxes but limited the overall yield to the equivalent of the maximum permissible real estate tax yield for the class of subdivision. During succeeding years limitations were imposed on the kinds of taxes that might be levied and also on the maximum rates for permissible taxes. Where maximum rate limits are imposed on individual taxes, the limit must be shared equally by a school district and any municipality within its boundaries levying the tax unless a different sharing is mutually agreeable. The city of Pittsburgh is able to levy and collect the maximum rate on any Act 511 taxes it uses because the school district, with separate taxing authority, does not come under the act. The act was extensively rewritten in 1965 and emerged as a new Act 511 of that year.

The per capita, occupation and mercantile taxes that may be levied both under the authority of Act 511 and under other laws have already been discussed. Following are other taxes that are levied pursuant to this act together with limits on maximum rates if there are such. In addition to the taxes dealt with here, the act contains a limit of two percent on sales taxes on transfer of tangible personal property. Nowhere else in the act is there

specific authority to levy a sales tax and such a local tax would appear to be subject to the prohibition against a tax "on a privilege, transaction, subject, occupation or personal property which is now or does hereafter become subject to a state tax or license fee." In any case, no such taxes are levied locally.

Earned Income Tax

This tax is levied upon the wages, salaries, commissions, net profits, or other compensation of those who earn income within the taxing jurisdiction. It is applicable to employed individuals, unincorporated businesses, partnerships and professional persons. Political subdivisions imposing this tax are subject to uniform provisions, contained in Act 511, governing the scope of the tax and the procedures for its collection. So-called "unearned income" from rentals or investments is not included. School districts may not levy the tax upon non-residents. For cities, boroughs and townships, any such tax paid in the taxing district of residence becomes a credit against a tax liability in a taxing district of employment. Furthermore, any tax paid in Philadelphia under the Sterling Act becomes a credit against an income tax liability under this act in a district of residence in a suburb. As a result, there are few income taxes in the Philadelphia suburban area.

This tax is subject to a maximum rate of one percent which must be shared between the school district and the municipality if both impose the tax. An exception is the city of Scranton which, by amendment, has special authority in the act to impose a one percent tax regardless of the school district tax. Political subdivisions may require the withholding of wage taxes by employers within their jurisdiction if the tax is listed in a register published annually by the Department of Community Affairs.

Occupational Privilege Taxes

These taxes are levied upon individuals for the privilege of employment within the tax jurisdiction. This is the one tax which a political subdivision may collect from non-residents working within its borders regardless of what other taxes they pay where they live. The maximum rate is $10. Each person subject to an occupational privilege tax may be required to pay it only once during the year regardless of the number of jurisdictions in which he is employed during that period. The order of priority for the right of taxing jurisdictions to collect is specified for those cases where a person resides in one and is employed in one or more other jurisdictions.

A 1965 constitutional amendment authorized local taxing jurisdictions to exempt from occupational privilege taxes "persons deriving less than $1,000 per year from such occupation." (Art. IX, Sec. 1). The 1968 constitutional revisions deleted this specific exemption authority, although the effective date is not entirely clear, at the same time giving the legislature authority to provide for tax exemptions on a broader basis than this.

Real Estate Transfer Tax

The real estate transfer tax may be imposed at a maximum rate of one percent upon the transfer price of real property. The county recorder of deeds usually is the agent of the taxing jurisdiction for the collection of the tax although not necessarily so. Act 511 contains restrictions on the imposition of this tax on the transfer of property within families or in estate cases or other circumstances other than ordinary sale.

This tax provided the first example of what may happen when the Commonwealth imposes a tax that already is in use by political subdivisions under the terms of this act. Under Act of 1951 (P.L. 1742), as amended, the Commonwealth also imposed a real estate transfer tax at a rate of one percent.

That act contained a specific provision that it would not invalidate any similar taxes then or subsequently imposed by local governments under terms of existing legislation.

Other Taxes

An admissions tax may be enacted applicable to "places of amusement, athletic events and the like." The maximum rate is 10 percent. Under a 1965 amendment to the old Act 481 and continued in Act 511, all political subdivisions except the city Pittsburgh were prohibited from levying this tax on motion picture theaters effective January 1, 1966.

A tax may be levied on mechanical devices such as pinball machines, vending machines, juke boxes, or pool tables. The law contains no limit on the maximum rate of such a tax and it is found to be imposed either at a flat dollar rate or as a percentage of the receipts of the machine or device.

Restrictions on Taxing Authority

Act 511 contains a number of restrictions on the taxing authority granted local subdivisions, most of which were enacted at an early date in the history of old Act 481 and most of which represented reactions to certain taxes that had been imposed by one or more political subdivisions. These restrictions include prohibitions of local taxation of natural resources, manufactured products, farm products or the preparation and processing thereof, transportation, loading, unloading, dumping or storage; school district taxation of the income of non-residents; taxes on personal property subject to the four mill county tax (Pittsburgh city is not subject to this prohibition); gross receipts, services, privileges and transactions connected with the rendering of public utility services. Taxes may not be levied on mobile homes or house trailers that are subject to real estate taxes unless the same tax is levied on all other real

property in the subdivision.

The aggregate of all local taxes levied by a political subdivision under the provisions of Act 511 may not exceed the equivalent of 12 mills on the market value of taxable real estate.

Non-Property Taxes - Their Use & Yield

Pennsylvania's local governments raised over $1½ billion in tax revenues in 1967 (school districts - 1967-68). Two-thirds of this came from real estate taxes and the remaining third from other taxes.

Details concerning tax yields and uses are shown in Tables 1, 2 and 3 on pages that follow.

Over a quarter of a billion dollars was raised from the earned income tax (Table 1) and, in light of Philadelphia's subsequent increase in rate plus normal growth, it is likely that the tax is bringing in about $400 million during the current year.

For counties, in total, the personal property tax runs second to the real estate in importance (Table 2). For all other classes of jurisdictions the income tax returns the second highest percentage of total taxes. The percentages shown here obscure the fact, revealed in Table 3, that individual taxes are levied by only a portion of the jurisdictions eligible to use them but that, on the other hand, every tax shown is an important revenue source for certain political subdivisions.

The non-real estate tax most commonly levied is the per capita tax (Table 3) imposed by 2,075 jurisdictions under Act 511 and by 709 under the various codes (obviously, many of these overlap). The next most frequently imposed tax is the earned income tax -- the largest revenue producer. The mercantile tax is used most intensively by cities, the occupation tax by boroughs and second class townships.

Table [illegible]
Tax Yields by Class of Pennsylvania
Taxing Jurisdiction - 1967
($000)

	Total Taxes	Real Estate	Personal Property	Non-Property: Under Codes: Occupation	Under Codes: Per Capita	Under Act 511: Occupation	Under Act 511: Per Capita	Under Act 511: Earned Income	Under Act 511: Mercantile	Under Act 511: Realty Transfer	Under Act 511: Occupational Privilege	Under Act 511: Amusement	Under Act 511: Other
Philadelphia													
City [a]/	$ 261,352	$ 104,577	$ 4,952	-	-	-	-	$126,242	$21,207	$ 3,736	-	$ 643	$ 694
School District [b]/	109,714 [n]/	85,777	2,814 [d]/	-	-	-	-	-	9,[illegible]0 [f]/	-	-	-	1,041 [g]/
Pittsburgh													
City	55,362	33,741	1,326 [e]/	-	-	-	-	11,342	2,024 [h]/	972	$ 3,255	1,459	1,233
School District [c]/	31,527 [n]/	20,634	1,251	-	-	-	-	5,502	1,467 [i]/	-	-	-	-
Counties [j]/	169,433	130,948	15,375	$1,089	$ 2,021	-	-	-	-	-	-	-	-
Third Class Cities [m]/	73,811	45,918	-	12	1,228	- [k]/	$ 864	16,277	2,553	1,270	5,519	92	79
Boroughs	79,331	49,438	-	1,005	2		3,993	16,910	606	1,678	3,138	165	345
Townships													
First Class	43,443	32,222	-	36	-	- [k]/	819	6,782	262	2,101	809	310	22
Second Class	48,868	27,864	-	205	-		4,426	12,325	141	3,002	537	331	17
School Districts													
Second Class	228,730 [n]/	188,583	-	-	3,414	$ 3,33[illegible]	4,134	19,241	416	3,778	[l]/	79	167
Third Class	406,901 [n]/	304,754	-	-	10,827	12,56[illegible]	11,848	48,552	414	6,315	[l]/	491	651
Fourth Class	32,891 [n]/	23,669	-	-	1,075	1,585	1,175	3,368	3	432	[l]/	70	20
Total	$1,541,364 [n]/	$1,068,175	$24,818	$2,347	$18,566	$17,70[illegible]	$27,259	$268,542	$38,783	$23,285	$13,338	$3,660	$5,269

Table 1

a/ Philadelphia City government - in reality a consolidated city-county government. Taxes, similar to "Act 511" taxes, are levied under authority of the Sterling Act.

b/ Philadelphia City School District taxes are authorized by ordinance of the Philadelphia City Council.

c/ Pittsburgh City School District taxes are specifically authorized by the State Legislature.

d/ Philadelphia City School District Unearned Income Tax.

e/ Pittsburgh City Personal Property Tax is imposed under Act 511.

f/ Philadelphia City School District General Business Tax.

g/ Philadelphia City School District Pari-Mutuel Betting Tax.

h/ In addition, Pittsburgh City imposes a Business Privilege Tax, effective February 1, 1969.

i/ Pittsburgh City School District Mercantile License Tax.

j/ Excludes Philadelphia County. County government in Philadelphia is not separate from the city government.

k/ Included in "All Other". Tax is imposed by only ten municipalities - eight boroughs and two second class townships.

l/ Included in "All Other". Tax is imposed by a relatively small number of school districts. Exact number is not known.

m/ Includes second class A city - Scranton City

n/ Total - includes delinquent taxes and payments in lieu of taxes as follows:

	Delinquent ($ 000)	Payments in lieu of Taxes
Philadelphia School District	$ 9,329	$ 274
Pittsburgh School District	2,524	149
Second Class School Districts	5,242	321
Third Class School Districts	9,712	575
Fourth Class School Districts	1,192	202
Total	$27,999	$1,521

Table 7
Percent to Total Taxes of Individual Tax Yields
by Class of Pennsylvania Taxing Jurisdiction - 1967

	Total Taxes	Real Estate	Personal Property	Non - Property: Under Codes: Occupation	Under Codes: Per Capita	Under Act 511: Occupation	Per Capita	Earned Income	Mercantile	Realty Transfer	Occupational Privilege	Amusement	Other
Philadelphia													
City a/	100.00%	40.01%	1.55%	-	-	-	-	48.30%	8.11%	1.13%	-	.25%	.34%
School District b/	100.00n/	78.18	2.56 d/	-	-	-	-	-	8.32 f/	-	-	-	1.66g/
Pittsburgh													
City	100.00	60.34	2.40 e/	-	-	-	-	20.49	3.67h/	1.76	5.30%	2.64	2.23
School District c/	100.00n/	65.45	3.97	-	-	-	-	17.45	4.55i/	-	-	-	-
Counties j/	100.00	89.09	9.07	.04%	1.19%	-	-	-	-	-	-	-	-
Third Class Cities m/	100.00	62.21	-	.02	1.66	-	1.17%	22.05	3.43	1.72	7.48	.12	.11
Boroughs	100.00	62.38	-	1.27	*	k/	5.03	23.34	.76	2.12	3.96	.21	.43
Townships													
First Class	100.00	74.17	-	.08	-	*	1.88	15.61	.60	4.84	2.05	.71	.05
Second Class	100.00	57.02	-	.42	-	k/	9.06	25.22	.29	6.14	1.10	.72	.03
School Districts													
Second Class	100.00n/	82.45	-	-	1.49	1.47%	1.31	8.41	.13	1.65	l/	.03	.07
Third Class	100.00n/	74.90	-	-	2.66	3.11	2.91	11.96	.10	1.55	l/	.12	.16
Fourth Class	100.00n/	71.96	-	-	3.27	5.12	3.57	10.24	.01	1.31	l/	.21	.06
Total	100.00n/	69.30	1.61	.15	1.20	1.15	1.77	17.13	2.52	1.51	.86	.24	.34

*Less than .005 percent

FOOTNOTES

Table 2

a/ Philadelphia City government - in reality a consolidated city-county government. Taxes, similar to "Act 511" taxes, are levied under authority of the Sterling Act.

b/ Philadelphia City School District taxes are authorized by ordinance of the Philadelphia City Council.

c/ Pittsburgh City School District taxes are specifically authorized by the State Legislature.

d/ Philadelphia City School District Unearned Income Tax.

e/ Pittsburgh City Personal Property Tax is imposed under Act 511.

f/ Philadelphia City School District General Business Tax.

g/ Philadelphia City School District Pari-Mutuel Betting Tax.

h/ In addition, Pittsburgh City imposes a Business Privilege Tax, effective February 1, 1969.

i/ Pittsburgh City School District Mercantile License Tax.

j/ Excludes Philadelphia County. County government in Philadelphia is not separate from the city government.

k/ Included in "All Other". Tax is imposed by only ten municipalities - eight boroughs and two second class townships.

l/ Included in "All Other". Tax is imposed by a relatively small number of school districts. Exact number is not known.

m/ Includes Second Class A City - Scranton City

n/ Total includes delinquent taxes and payments in lieu of taxes as follows:

	Delinquent	Payments in lieu of taxes
Philadelphia School District	8.50%	.25%
Pittsburgh School District	8.01	.47
Second Class School Districts	2.29	.14
Third Class School Districts	2.39	.14
Fourth Class School Districts	3.62	.61
Total	1.82%	.10%

Table 3
Use of Non-Real Estate Taxes by Class of Pennsylvania Taxing
Jurisdictions - 1967

	Total Number	Personal Property	Non - Property: Under Codes		Non - Property: Under Act 511							
			Occupation	Per Capita	Occupation	Per Capita	Earned Income	Mercantile	Realty Transfer	Occupational Privilege	Amusement	Mechanical Devices
Philadelphia												
City a,g/	1	x	-	-	-	-	x	x	x	-	x	-
School District b/	1	x d/	-	-	-	-	-	x f/	-	-	-	-
Pittsburgh												
City	1	x c/	-	-	-	-	x	x h/	x	x	x	-
School District c/	1	x	-	-	-	-	x	x i/	-	-	-	-
Counties j/	66	66	21	23	-	-	-	-	-	-	-	-
Third Class Cities l/	49	-	1	24	-	18	[illegible]	29	25	33	7	21
Boroughs	958	-	541	11	8	523	562	27	322	142	35	136
Townships												
First Class	91	-	13	-	-	38	50	3	73	28	22	33
Second Class	1,463	-	455	20	2	918	680	6	391	48	93	21
School Districts												
Second Class	57	-	-	31	10	32	36	6	50	k/	4	-
Third Class	415	-	-	356	80	383	322	15	264	k/	38	4
Fourth Class	268	-	-	244	90	213	180	2	96	k/	10	1
Total	3,371	70	1,031	709	190	2,075	1,883	92	1,223	247	211	216

FOOTNOTES

Table 3

a/ Philadelphia City government - in reality a consolidated city-county government. Taxes, similar to "Act 511" taxes, are levied under authority of the Sterling Act.

b/ Philadelphia City School District taxes are authorized by ordinance of the Philadelphia City Council.

c/ Pittsburgh City School District taxes are specifically authorized by the State Legislature.

d/ Philadelphia City School District Unearned Income Tax.

e/ Pittsburgh City Personal Property Tax is imposed under Act 511.

f/ Philadelphia City School District General Business Tax.

g/ Philadelphia City School District also levies a Pari-Mutuel Betting Tax.

h/ In addition, Pittsburgh City imposes a Business Privilege Tax, effective February 1, 1969.

i/ Pittsburgh City School District Mercantile License Tax.

j/ Excludes Philadelphia County. County government in Philadelphia is not separate from the city government.

k/ Tax is imposed by a relatively small number of school districts. Exact number is not known.

l/ Includes 2nd class A city - Scranton City

Note: The real estate tax is levied by all taxing jurisdictions except one borough and five second class townships.

The Committee finds that, in general, the tax structures of Pennsylvania's counties, municipalities and school districts have numerous built-in inequities, are relatively regressive, and include a number of nuisance taxes. The regressive nature of the real estate tax and of certain flat rate personal taxes are not compensated by any progressive characteristics of present local taxes on earned income. The broad provisions of the Local Tax Enabling Act (Act 511 of 1965) permit taxes which duplicate certain taxes authorized under the respective local government codes and thus lead to overlapping or duplicate taxes levied upon the same subjects. Despite the availability to municipalities and school districts of numerous types of non-property taxes, the limits imposed on the rates and the manner of allocating taxes as between taxing jurisdictions of employment and those of residence have restricted the productivity of non-property tax sources in the urban centers and resulted in undue pressure on the real estate tax. These and other aspects of the Committee's findings are commented on in more detail below.

Earned Income Tax

The Committee finds that the earned income tax, although the most productive of local non-real estate taxes, has several shortcomings.

First, the tax is not progressive in its impact upon the taxpayer. Since the tax must be levied at a flat rate upon earned income, without any exemptions or deductions, the impact of the tax at best can be only proportionate - that is the same percentage at all levels of earned income.

Second, the tax is limited to earned income, including net profits of unincorporated businesses, proprietorships and professions, and does not include other forms of income such as rents, royalties, interest or dividends. This, of course, narrows the tax base and thus reduces the yield from any particular tax rate. It also may have the effect of making the tax regressive in certain cases if it is assumed that persons in higher

income brackets are likely to have greater proportions of income from investment sources. Thus, a flat rate tax on earned income may become a decreasing percentage of total income at higher salary levels.

Third, the existing statutory limit on tax rates has proven too restrictive to meet the needs of many local governments. Outside of Philadelphia, Pittsburgh and Scranton, the maximum rate limit of the tax most commonly is shared between the municipality and the coterminous or overlapping school district. Thus, the nominal one percent rate limit becomes one-half of one percent for each taxing body. As a result, in the larger urban centers (cities and a few boroughs) with the earned income tax being collected from resident workers only, total revenue needs are likely to require imposition of real estate taxes which are substantially higher than those in the surrounding suburban areas. School districts, most of whom levy the earned income tax at the highest rate available to them, nevertheless find it necessary to impose real estate taxes far higher than the nominal statutory rate limits, which can be exceeded in order to pay such costs as mandated teacher salaries, debt service and authority rentals.

Fourth, the collection of tax is too fragmented to be economical and fully effective. Although there are a number of joint centralized wage tax collecting bureaus, most of the local taxing jurisdictions in the Commonwealth collect the tax individually. Complications are created, both for the taxpayer and for the employer who must withhold, by the multiplicity of taxing units and by the overlapping of school districts on municipalities with whom they may or may not share the tax. Small taxing jurisdictions lack the resources for strong enforcement and the size to permit economical collection procedures.

The Occupation Tax

The occupation tax, dating back to the last century, apparently was intended originally to bear some equitable relationship to a taxpayer's ability to pay, through a system of graded valuations based upon the presumed earning potential of his occupation. In actual practice, and particularly in the modern era, the tax has become highly inequitable because of widely varying standards and procedures and because of inaccurate assessments. With the advent of the local earned income tax, the occupation tax has lost any validity it might have had as a tax related to the ability to pay of the taxpayer.

Where the tax is imposed at rates comparable to those of local real estate taxes, under various of the local government codes, the yield is relatively insignificant and sometimes so low as barely to offset the cost of administering and collecting the tax. In such circumstances it can tru be designated a nuisance tax.

Where the tax is imposed, as it now is, by a number of school districts, under the authority of Act 511 and at unlimited and extremely high millage rates, the basic inequities of the tax are magnified for the taxpayers in those jurisdictions.

The occupation tax also may be levied at a flat rate subject to a limit of $10.00. Such a tax is only a per capita tax under another name. The occupational privilege tax, imposed at a flat rate with a $10.00 limit upon all who are employed within the taxing jurisdiction, will be considered in the discussion of non-resident taxation.

The Per Capita Tax

The Committee believes that the per capita tax, as presently imposed in Pennsylvania, is not a desirable tax for several reasons. First

its flat rate makes it regressive in nature. Second, because of its imposition under the authority of both Act 511 and the several local government codes, the taxpayer is subject not to one, but to several per capita taxes (as many as five in a third class city). Third, because the flat rate makes it necessary to maintain a relatively low rate limit, and because of poor enforcement, the yield from an individual tax is rather modest.

Taxation of Non-Resident Workers

The centers of employment in the Commonwealth, to which thousands of workers commute each day, returning to their homes at night, often have inadequate tax resources to meet the costs of governmental services provided for these workers.

With the sole exception of the City of Philadelphia, a municipality levying an income tax must allow full credit to non-resident workers for taxes they pay to their municipalities of residence. As a result, the imposition of an income tax by an urban employment center invariably has been followed by a "ripple" effect in the adoption of income taxes by the surrounding suburban jurisdictions. The sole available tax that is directly

related to employment is the occupational privilege tax which is imposed (mostly by municipalities -- only a handful of school districts) at a flat rate subject to a $10.00 limit. This tax suffers from the inequity and regressiveness of a flat rate tax, and the modest yield potential imposed by the $10.00 limit. (The regressiveness of the occupational privilege tax has been lessened by the authority granted local governing bodies to exempt those individuals earning less than $1,000 annually from the occupation which authority, however, is in doubt since adoption of the 1968 Constitutional amendments.)

The rigid limitations upon the ability of municipal governments in urban centers to impose and collect tax revenues from their non-resident workers undoubtedly is also a factor in the relatively high level of their real estate taxes compared with the suburban areas.

The Personal Property Tax

The Committee notes that the tax on intangible personal property levied by counties (plus Pittsburgh City and school district) at present produces tax revenues from owners of various kinds of securities and investments who are not subject to any local or state tax on the income from those investments.

Although the yield from the tax is high in a few counties, its collection and enforcement admittedly are poor in the majority of the counties. Intangible personal property cannot be identified as easily as can real estate, and the tax is self assessed. Most counties do not set up the staff, incur the expense, nor make truly diligent efforts to identify potential taxpayers. The enforcement tools available to the counties were augmented a few years ago with the availability, through the state Department of Revenue, of federal IRS tapes with sufficient information to identify those taxpayers receiving income from investments.

A problem of lack of equity exists with regard to the personal property tax in that the tax is imposed upon the value of the investments but without regard to the income returned by those investments. The tax is due whether income is received or not. For an example, on investments yielding six percent, the four mill tax becomes equal to a tax of 6 2/3 percent on the income from the investment. A tax of 12 mills (the aggregate collected in Pittsburgh) becomes equivalent to a tax of 20 percent upon the income. The inequity of the personal property tax will become more significant when a state income tax is imposed which also applies to the income from investments, and the local income tax base is adjusted accordingly.

The analogy often is made that taxes also are paid on real estate whether or not that property yields income. However, real estate is used and provides either a residence or a base for business operations for the taxpayer. The value of real estate is directly related to benefits provided by the quantity and quality of local government services, particularly municipal services, but not excluding the quality of public education nor the services of county government. The same is not true with regard to intangible personal property the value of which is likely to bear no relationship at all to the local government services in the taxing jurisdiction of the owner.

Philadelphia

The Committee finds a serious fiscal problem existing in the City of Philadelphia with specific respect to its revenue resources. The extremely broad taxing authority granted by the Sterling Act, including the power to retain earned income taxes collected from non-resident workers, simply is not sufficient to meet the burgeoning requirements of municipal government in a city that is the largest in Pennsylvania and the fourth largest in the nation.

The city's economic base generally and real estate tax base particularly have been deteriorating. Industrial, wholesale and retail enterprises are moving across the city line as are higher income taxpayers. The city's population increasingly is composed of the low-income under-privileged who create need for more local government services and spending. Further increases in taxes at a time when real estate taxes are high and the earned income tax rate is three times higher than in the rest of the state, can only encourage the exodus of business and taxpayers.

collection and a savings in the cost. There also would be much less work and resulting irritation for the taxpayer who would be able to base all his tax returns on the same calculations.

2. That school districts, other than Philadelphia and Pittsburgh, be authorized to levy income taxes (on the state base) without limit as to rate, but applicable only to residents of the district.

The removal of the limit on income tax rates would provide school districts with a significant enlargement of their revenue raising power to be used as they find necessary. The limitation of this tax to residents of the district corresponds to present law and is, the committee believes, fully justified in that the benefits of services of school districts generally do not apply to non-residents.

3. That all municipalities (but not counties) except for the city of Philadelphia, be authorized to levy an income tax (on the state tax base), without limit as to rate on all the earned and unearned income of persons residing within the municipality, but subject to rate limitation on income earned within the municipality by non-residents. A taxpayer would be credited, against tax liability in his municipality of residence with the tax paid on his earned income in his municipality of employment.

For taxpayers living in one municipality and working in another, the allocation of the tax on earned income would be shifted from the place of residence to the place of employment. That portion of the tax newly to be based on unearned income, however, would be collected by the municipality of residence. (Allowable exemptions could be apportioned between earned and unearned income according to the ratio that each bears to total income.)

The retention of the earned income tax by the municipality of employment would provide a source of revenue from non-resident workers, related to the amount of their income and more generous in yield than the present occupa-

tional privilege tax. A limitation on the rate of the tax to be retained would, however, protect those who have no voice in the tax imposition.

This recommendation would affect the tax yields of individual municipalities in different ways which the Committee finds it impossible to calculate from available data. Those municipalities which are centers of employment would stand to gain substantial revenue. Certain suburban or rural local governments which have relatively little employment might stand to lose revenue under an existing tax rate, subject to a potential offset - significant in affluent communities - by retention of the entire portion of the tax on unearned income. However, in light of the present day dispersion of commercial and industrial locations, there are hundreds of small municipalities and suburban jurisdictions where this change would have a "give and take" effect on local revenues.

The elimination of any rate limit on the income tax as it applies to residents would afford municipal governments the opportunity to make such use of this tax source as they find necessary either to meet new and additional revenue needs, to relieve an overburdened real estate tax or, insome cases, to compensate for taxes lost due to residents working outside the municipality. It is possible, in those municipalities that are employment centers, that the yield from the income tax might permit reduction in the level of the real estate tax, thus either reducing the disparity between the center city and suburban real estate tax levels, or making it possible for the urban school district to make greater use of the real estate tax. Finally, greater reliance on the real estate tax likely would occur in the suburbs where values are stable and are most likely to grow.

4. <u>That municipal and school district income taxes be collected by the Commonwealth, together with the state income tax, and allocated to the taxing jurisdictions to which they are due.</u>

The allocation of tax revenues to local taxing jurisdictions would

be on the basis outlined in recommendations Nos. 2 and 3. School district taxes would go to the districts of residence. Municipal taxes on earned income would go to the municipality of employment and those on unearned income would go to the municipality of residence.

The imposition of both state and local income taxes on the same base would permit a unified collection system that would offer advantages to both levels of government and to the taxpayer including the following:

a) Withholding of salaries and wages would be on a single return.

b) The taxpayer would have to fill out only one set of forms.

c) The savings resulting from a large scale collection operation would become possible.

d) State-administered collection and enforcement machinery would be the most effective.

e) The power to impose local taxes and to determine rates would remain vested in municipalities and school districts.

5. <u>That the following taxes be abolished:</u>

<u>The occupation tax</u>

<u>The occupational privilege tax</u>

<u>The per capita tax</u>

<u>The Mercantile Tax</u>

As stated in its findings, the Committee believes that the occupation tax is a "nuisance tax" in the worst sense of the word and that, with the increased availability and potential reliance on the income tax, there is no reason for its continued existence. The allocation of the municipal income tax to the place of employment eliminates any need for the occupational privilege tax and furthermore replaces it with a much higher revenue yield.

The Committee further believes that the flat rate, regressive per capita tax should yield to increased reliance on a newly broadened income tax

which local governments will have full authority to use as they find necessary.

In light of the imposition of both state and local personal income taxes which also apply to proprietorships and unincorporated business, and the existence of state corporate taxes, there no longer is any justification for local mercantile gross receipts or business privilege taxes.

6. That the personal property tax as levied by counties and by the City of Pittsburgh be abolished. (This recommendation does not include the Pittsburgh school district which has special taxing authority.)

With the imposition of a state tax that will include unearned income and the alteration of the bases for local taxes to correspond to the state base, the income from investments will now be subject to tax. The former justification for the personal property tax - that it taxed persons whose holdings were not otherwise subject to state or local taxation - will no longer exist.

The Committee has already stated the reasons why it believes this to be an inequitable tax.

7. That the real estate transfer tax be allocated entirely to county governments.

The Committee intends this to compensate counties for the loss of the personal property, occupation, and per capita taxes as revenue sources. The latter two taxes produce insignificant portions of revenue in all but a very few counties. The realty transfer tax, in the aggregate, produces about 20 percent greater revenue than does the county personal property tax, although the result in individual counties has not been estimated. This tax would be relatively easy for counties to administer since it rather commonly is collected for municipalities or school districts by the recorder of deeds.

The loss of this tax source by municipalities and school districts should create no difficulty in light of the expansion of other sources.

8. <u>That the taxing authority of the City of Philadelphia remain as now set forth in the law, subject to the following modifications:</u>

a. <u>That the City allow a credit against its earned income tax equal to 50 percent of the tax paid by a city resident to another municipality where employed.</u>

b. <u>That the City allow a credit against its earned income tax equal to 50 percent of the tax paid by a non-resident worker to his or her municipality of residence.</u>

c. <u>That the Commonwealth, from the proceeds of the recommended state income tax, reimburse the City for the tax revenue lost due to the above credits.</u>

This recommendation provides no additional revenue for the City of Philadelphia. It will permit suburban municipalities to use the income tax while avoiding an intolerable burden on the taxpayer who either <u>lives</u> or <u>works</u> in Philadelphia but not <u>both</u>. This portion of the cost of Philadelphia's particular fiscal problems will be spread among all taxpayers, rather than just those in the metropolitan area. This recommendation also presumes that the income tax rate in Philadelphia will continue to be higher than those in the surrounding municipalities.

It has become quite obvious to the Committee that Philadelphia cannot be fitted within a uniform tax structure applicable to all municipalities in the state. It was feared that application of the base of the new state income tax to the City income tax might further accelerate the flight of higher income taxpayers - particularly in view of the existing school district tax on unearned income.

Numerous alternative courses of action were considered. These included different bases for allocating the income tax between place of employment and place of residence; a state subsidy to compensate for revenue losses resulting

from adhering to a uniform new local tax structure; state subsidies for certain municipal functions of particularly high cost in a large city; and special authority for a local sales tax on the same base as the state tax and to be collected simultaneously with the latter.

The Committee concluded that it lacked the time to deal adequately with Philadelphia's fiscal problems. The recommendation that has been made must be regarded as a possible interim measure until more permanent solutions can be devised. The Committee further urges that its recommended Permanent Tax Advisory Committee deal specifically with the fiscal problems of the entire Philadelphia metropolitan area.

9. <u>That implementation date for these recommendations be established in the law as the beginning of a fiscal year for each class of local government at least one year following the effective date for collection of the proposed state income tax</u>.

Changes in tax structure, particularly as far-reaching as those recommended here, require careful planning on the part of each local governing body, cannot be instituted during a fiscal year, but must be a part of the budgeting process. The focal point of the recommended tax program is the change in the local income tax base and in the manner of allocating the tax between place of employment and place of residence. It would be almost impossible for local governing bodies to estimate the yields from the new tax, and therefore the tax rates that they need, without the information that should become available with the beginning of collection of the state income tax.

Therefore, the recommended postponement of at least one year, which further assumes that the state tax collection procedure will include an information system, using computer techniques, that will provide the required data. The postponement will also permit refinement of the state's collection procedures before the collection of local taxes is "piggybacked" on top.

Summary of Recommendations

The preceding recommendations concerning non-real estate taxes, do not affect amusement taxes nor certain lesser taxes available to municipalities and school districts under the provisions of Act 511. These recommendations also do not deal with the real estate tax, the yield of which will be affected by proposed new assessment legislation being recommended elsewhere.

Following is an exhibit summarizing the effect of these recommendations upon the taxing authority of counties, municipalities and school districts:

Effect of Committee Recommendations
on Local Government Taxing Authority

Tax	Counties	Municipalities	School Districts
Income	--	Include unearned income. No rate limit. 100% of earned income tax to place of employment, subject to rate limit.	Include unearned income. No rate limit. Residents only.
Per Capita	Abolished	Abolished	Abolished
Occupations	Abolished	Abolished	Abolished
Occupational Privilege	--	Abolished	Abolished
Mercantile	--	Abolished	Abolished
Realty Transfer	New	Abolished	Abolished
Amusement	--	Retained	Retained
Personal Property	Abolished	Abolished (Pittsburgh only)	Retained (Pittsburgh only)

Counties would lose the revenues they now receive from the per capita or occupation taxes (a county may not impose both) and the personal property tax. It is anticipated that this loss would be substantially - and often entirely - offset by the real estate transfer tax to be permitted counties.

Boroughs and townships would lose the occupation tax (which, however, produces an inconsequential yield) and all municipalities would lose the per capita, the occupational privilege and the mercantile taxes. The loss of the

occupational privilege tax would be more than offset by the allocation to the place of employment of the earned income portion of the income tax. Although it is not possible to document the effect of the earned income allocation provision that is recommended, it would appear that the urbanized municipality that is likely to have the greatest need for increased revenue would be most likely to realize significant increase under this change. Furthermore, the removal of the rate limit would permit unlimited local discretion in the revenue to be raised from residents through this tax. The revenue loss from the realty transfer tax would not be significant in most cases but the mercantile tax would be missed in a number of cities that are commercial centers. The broadening of the base and the elimination of rate limits of the income tax must be looked to to compensate for those losses.

It also is likely that "bedroom" municipalities which have little business and most of whose residents work elsewhere, would have to fall back almost entirely on the real estate tax. They would lose most of the earned income tax, if they now collect it, together with the per capita and realty transfer taxes which they now use rather extensively. These losses would be balanced only by the tax on unearned income. Whether the resulting real estate tax levels would be burdensome would depend on existing tax levels, which admittedly are not high in many suburban and rural municipalities.

School districts would lose the use of the per capita tax, the occupation tax and the real estate transfer tax. The occupation tax is used by a relatively small number of districts, but by some of those it is used very intensively. The removal of the limit on income tax rates would strengthen the revenue raising powers of school districts, but this tax source would also have to overcome the loss of the per capita, occupation and realty transfer taxes.

BUSINESS TAXES

The Committee considered and reviewed all major corporate taxes paid by the business community to the Commonwealth of Pennsylvania and makes the following general recommendations with respect to the elimination of specific taxes, changes in certain tax rates, the elimination or modification of specific exemptions, and other technical amendments in the nature of tax reform to close existing tax loopholes.

Recommendation No. 1

The Corporate Net Income Tax rate should be reduced from twelve percent (12%) to ten percent (10%), provided that the present tax base is expanded in order to offset at least part, if not all, of the general fund revenue loss occurring as a result of such reduction.

The Commonwealth of Pennsylvania currently imposes a corporate net income tax at the rate of 12 percent (12%) per year. Pennsylvania has the dubious distinction of having the highest corporate net income tax rate in the United States. The next highest rate among the forty-three states imposing a corporate net income tax is Minnesota with a rate of eight and one-half percent (8-1/2%).

In light of the lower corporate net income tax rates imposed by all the states which are contiguous to Pennsylvania, excluding Ohio which has no corporate net income tax, the Committee recommends that the corporate net income tax rate be reduced from twelve percent (12%) to ten percent (10%) in order to engerder a healthy and competitive business tax climate.

Recommendation No. 2

The destination point concept should be used in lieu of the office concept as a basis for the allocation of gross receipts in both the Corporate Net Income and Franchise Taxes

Since both the Corporate Net Income Tax and Franchise Tax are excise taxes for the privilege of doing business in Pennsylvania, the state is limited to taxing only the portion of the corporation's value or income attributable to Pennsylvania. Both taxes use gross receipts as one of the three factors of its apportionment formula to measure the business activities conducted in the state.

The statute provides that the fraction shall have as its numerator the gross receipts from business assignable to Pennsylvania, and the denominator shall be the total gross receipts received by the corporation. The exact language of the statute is as follows:

> "The amount of the corporation's gross receipts from business assignable to this Commonwealth shall be (1) the amount of its gross receipts for the taxable year except those negotiated or effected in behalf of the corporation by agents or agencies chiefly situated at, connected with, or sent out from premises for the transaction of business maintained by the taxpayer outside of the Commonwealth, . . ."
> (72 P.S. 3420 (b)). (Emphasis added.)

In view of the Supreme Court's interpretation of the language used in these statutes in Commonwealth v. General Foods, 429 Pa. 266 (1968), and Commonwealth v. Hellertown, Pa. (1970), corporations can materially reduce their Pennsylvania corporate tax burden by removing the offices with which their salesmen are "connected" outside the state. Once the office to which the salesmen are assigned is removed from the state, the gross receipts from sales by those salesmen made in Pennsylvania are no longer assignable to Pennsylvania. The General Foods Corporation, a large multi-state corporation

which makes approximately six percent (6%) of its sales in Pennsylvania, reduced its tax burden by moving its sales offices from Pennsylvania to various geographic locations just outside the state. This "change of Office" loophole caused only .005% of the sales to be assignable to Pennsylvania, and the corporation thus substantially reduced its corporate tax liabilities to the Commonwealth of Pennsylvania.

In the Hellertown Manufacturing Co. case, the corporation substantially reduced its sales assignable to Pennsylvania by establishing an out-of-state office where it negotiated and effected a contract for the sale of its entire output to its parent corporation located outside the Commonwealth of Pennsylvania, even though the shipment of its products were made directly to the customer from the Pennsylvania plant.

The Committee recommends that these loopholes be eliminated by changing the base of the gross receipts fraction to a "destination point" rather than an "office" concept. This could be accomplished by the enactment of the Uniform Division of Income for Tax Purposes Act by the Commonwealth of Pennsylvania. If it is not practical to adopt the Uniform Act in its entirety, the third fraction, i.e., the gross receipts fraction, should at least be changed to a destination point basis.

Furthermore, the Committee recommends that if for any reason, the destination point concept is not adopted, the language of the statute relating to the allocation of the gross receipts should at least be revised to provide that all of the taxpayer's gross receipts from business assignable to this Commonwealth shall be the amount of its gross receipts for the taxable year except those negotiated or effected in behalf of the taxpayer by agents or agencies chiefly situated at or sent out from premises for the transaction of business maintained by the taxpayer outside the Commonwealth. This suggested amendment would eliminate the controversial words

"connected with" now present in the statute, and result in increased revenues, but it is emphasized that it would not be as satisfactory as adoption of the Uniform Division of Income Act.

Recommendation No. 3

If the Uniform Act is not enacted, the wages and salaries fraction of the apportionment formula for the Corporate Net Income Tax and the Franchise Tax should be amended to eliminate the language "connected with."

The Uniform Division of Income for Income Tax Purposes referred to with reference to the gross receipts fraction also includes a change in the make-up of the wage allocation.

In the event that the provisions of the Uniform Act are not adopted, the Committee recommends the wages and salaries fraction should be revised to omit the words "connected with." The elimination of this phrase will result in the allocation of all wages and salaries paid to employees of the corporate taxpayer except those wages and salaries that are paid to employees situated at or sent out from the premises for the transaction of business maintained by the taxpayer outside the Commonwealth.

There should also be inserted a provision that all wages and salaries paid to resident employees of corporate taxpayers should be allocated to this state.

Section 2(c) of the Corporate Net Income Tax Act relating to the allocation of gross receipts provided that if a taxpayer maintains an office, warehouse or other place of business in a state other than this Commonwealth for purposes of reducing its tax under this subsection, the Department of Revenue shall, in determining the amount of its gross receipts

from business assignable to this Commonwealth, include therein the gross receipts attributed by the corporate taxpayer to the business conducted at such place of business in another state. A similar provision with regard to the apportionment of a taxpayer's wages and salaries should be provided.

Recommendation No. 4

The statutory language permitting a corporation to allocate should be reformed to make it uniform and limit allocation to the Federal Constitutional requirement.

The language used in the introductory portion of the imposition section of the various corporate tax acts is not the same, and certain corporations are being accorded the right to allocation in instances where there is no constitutional provision requiring allocation.

The General Assembly has the right to determine, within constitutional limitations, whether or not a corporation is entitled to an allocation. Generally, allocation means a corporation can remove a portion of its tax base before the tax rate is applied to determine the amount of tax.

The Corporate Net Income and Corporate Income Taxes do not permit allocation unless the corporate taxpayer is "not transacting its entire business within the Commonwealth". The franchise tax, on the other hand, does not limit allocation to corporations who are not transacting their entire business within the Commonwealth.

As a result of this difference in language, the Supreme Court in Commonwealth v. Rieck Inv. Corp., 419 Pa. 52 (1965) permitted an allocation for property which was not connected with the corporate taxpayer's business in any way whatsoever. The taxpayer was a foreign corporation whose entire business was conducted in Pennsylvania with the exception of two lots of land which the corporation owned in Florida. The decision permitted the corporation to substantially reduce its Pennsylvania tax liability.

It should be noted that the corporation was not even "doing business" in Florida, because it merely owned two small lots there. The rationale for this decision was that the Franchise Tax does not require as a prerequisite to allocation that a corporate taxpayer be "doing business" in a state other than Pennsylvania.

Both the Corporate Net Income and the Corporate Income Tax Acts limit allocation to those corporations whose "entire business of any taxpayer is not transacted within this Commonwealth . . ."

The Court has recently expanded the meaning of the word "transacted" considerably. See Commonwealth vs. Tube City Iron and Metal Co., 432 Pa. 600 and Commonwealth vs. Hellertown Manufacturing Corp., Pa. (1970). It is the opinion of the Committee that any time a corporation has any connection with another state, no matter how tenuous, the Court is going to allow allocation.

The Committee recommends that the prefatory clause, "in case the entire business of any taxpayer is not transacted within this Commonwealth", should be revised so as to indicate a legislative intent to require allocation only where the Federal Constitution requires it, and that is, where a corporate taxpayer is "doing business", in the technical legal meaning of that term, outside the Commonwealth.

Recommendation No. 5

The dividends received deduction available to corporations under the Corporate Net Income Tax should be changed to conform to the federal tax treatment of dividends.

The deduction for dividends received should be repealed, thus providing that the taxpayer could not deduct for Pennsylvania corporate tax purposes the dividends which were includable in his federal taxable income. In other words, the tax base for state taxation should be the same tax basis as for federal purposes.

The Department of Revenue has informally estimated that this change would increase the corporate net income tax by, at least, five million dollars annually.

In Commonwealth v. General Refractories, 417 Pa. 153 (1965), the Court permitted a corporate taxpayer to deduct the value of certain magnesite received from an Austrian subsidiary company as a divident. The Commonwealth argued that the dividend deduction should be limited to those dividends received from corporations doing business in Pennsylvania. The Court specifically held that this was a deductible divident.

In light of this decision, the Committee gave consideration to recommending amendment of the Corporate Net Income Tax Act to limit the dividend deduction to dividends received from corporations "doing business" in the technical sense (and presumably paying Pennsylvania corporate taxes) in Pennsylvania. However, the Committee decided to treat all dividends received from all corporations on the same basis as for federal tax purposes.

With regard to dividends from foreign corporations (located outside of the United States), the Committee recommends that if the domestic corporation owns eighty percent or more of the outstanding voting stock of the foreign corporation, the domestic corporation be permitted to deduct all foreign dividends (100%) received from the foreign corporation.

If the domestic corporation owns less than eighty percent (80%) of the outstanding voting stock the domestic corporation would be allowed a deduction equal to eighty-five (85%) percent of the dividends received from the foreign corporation.

Recommendation No. 6

The Corporate Net Income Tax should be amended to make a corporation liable

for gains realized from the sale of property after the corporation has ceased to do business within the Commonwealth.

Where a corporation has ceased to do business and, therefore, is not subject to the corporate net income tax, the taxpayer may still hold title to real estate which it thereafter sells and realizes a capital gain.

The Committee recommends that wording be incorporated into the Act to require such corporations to file reports and to report as taxable the gain realized from the sale of said property.

A variation of the above situation is presented in those cases where the corporation sells its property on an installment basis. The corporate taxpayer should be required to file reports for all those periods when it receives installment payments and realizes a capital gain on the disposition of said property.

Recommendation No. 7

The Capital Stock Tax Act should be amended to prevent real estate companies from utilizing the manufacturing exemption, when the lessor company did not operate the manufacturing plant.

The Capital Stock Tax Act should be amended to correct the decision of Commonwealth Court in Commonwealth vs. Jeca Corporation, 81 Dauphin 36 (1963). The Court there held that a corporation that leased its plant to another corporate entity was entitled to the manufacturing exemption even though the lessor company did not itself operate the manufacturing plant. Reference was made to the Act of July 11, 1901, P.L. 668 which provides, in substance, that no corporation organized for manufacturing purposes, whose manufacturing plant or plants, in whole or in part, are or may be leased to another corporation,

shall, by reason of such leasing, be deprived of the exemption from taxation upon its Capital Stock, to which, under existing laws, it would be entitled if such lease had not been made.

As a result of the Jeca decision, real estate companies not involved in manufacturing are entitled to the manufacturing exemption if they amend their charters to obtain the power to manufacture and then lease a vacant building to a company that, in turn, uses the building for manufacturing.

The manufacturing exemption should not apply in such cases. Therefore, the Act of 1901 should be amended to limit the exemption to those corporations leasing plants that were actually engaged in manufacturing operations prior to the leasing of the plant. In addition, the words "plant or plants" should be limited to actual manufacturing facilities and not vacant buildings.

Recommendation No. 8

The Domestic and Foreign Excise Taxes should be repealed.

The Domestic Excise Tax (P.L. 564 of 1953) is imposed at a rate of one-fifth of one percent on the amount of authorized "stated capital" of Pennsylvania corporations and on any increase thereof. In general, "stated capital" is the par value of authorized capital stock or the consideration received for the sale of no-par value stock. The yield in 1969-70 was $2.9 million.

The Foreign Corporation Excise Tax (P.L. 150 of 1901) is imposed at a rate of one-third of one percent on capital actually employed in Pennsylvania by a foreign corporation and on any increase thereof. Capital is construed to be tangible property. The yield in 1969-70 was $ 4.9 million. Both taxes were changed from bonuses in 1953 in order to qualify for federal tax deduction.

The small yield from these excise taxes places them in the nuisance category. Furthermore, since they are "one-shot" taxes, their impact may be sufficient to discourage industrial expansion by imposing an additional tax every time such expansion occurs.

Should the General Assembly not adopt the Committee's recommendation to eliminate these nuisance taxes, the Committee recommends that at least the following technical amendments be made in order to close certain tax loopholes which exist under the present statutes:

The Foreign Excise Tax Act provides for the imposition of tax on capital that is employed "wholly" in this Commonwealth. Where a corporation's tangible property has been employed in the Commonwealth of Pennsylvania for only a portion of the year, the corporate taxpayer can claim that said property was not subject to the Foreign Excise Tax Act because it was not "wholly" employed in Pennsylvania during the year.

The Legislature never intended this result; hence the Committee recommends this Act should be amended to delete the word "wholly". For example, see H.B. 2031, Pr. 2596, introduced into the Legislature on November 30, 1967.

The Committee also recommends that the definition of "foreign corporation" should be expanded by deleting the wording "which has been issued a Certificate of Authority by the Department of State to do business within this Commonwealth". Commonwealth vs. 2101 Cooperative, Inc., 78 Dauphin 76, held that the real basis of said tax is the privilege of doing business in this Commonwealth, and that it was not a condition that said taxpayer be granted a Certificate of Authority to do business in this State.

The Committee further recommends that the definition of "increase of capital" should be amended. Subclause (b) in said definition in dealing with corporations admitted to do business in this Commonwealth after the effective date of the act requires corporations

to report capital actually employed within this Commonwealth at the time of or after receiving a Certificate of Authority to do business from the Department of State and any increase thereof. There are situations where a corporation commences operations in this Commonwealth prior to the date when it obtains a Certificate of Authority to do business from the Department of State. Therefore, the wording of the clause should be revised so as to require corporate taxpayers to file a report from the first day they begin business in Pennsylvania rather than as of the date they receive a Certificate of Authority.

Recommendation No. 9

The Corporate Loans Tax should be repealed.

The Committee believes that the Corporate Loans Tax is a nuisance tax and, therefore, should be repealed.

The Corporate Loans Tax applies to the indebtedness of Pennsylvania corporations which are owned by individual residents of Pennsylvania, provided interest is paid thereon. It also applies to the indebtedness of a foreign corporation doing business in Pennsylvania and having a treasurer resident in Pennsylvania, under the above circumstances. The tax in fiscal 1970 yielded $2.9 million.

The treasurer of the corporation issuing the indebtedness must ascertain whether any owners are individual residents of Pennsylvania and if so, the corporation must withhold the loans tax when paying the interest. This administrative duty vested in the corporation is costly and time-consuming, and together with the insignificant yield from the tax, gives rise of the "nuisance" designation.

If, however, the General Assembly does not adopt the recommendation to eliminate the corporate loans tax, the Committee recommends that at least the following

technical amendment be made with regard to removing the requirement of a resident treasurer:

Section 17 of the Corporate Loans Tax Act provides that a foreign corporation doing business in this Commonwealth is required to withhold the Corporate Loans Tax from the interest it pays on its obligations held by Pennsylvania residents provided it has a resident corporate treasurer located in this State. When the Commonwealth attempted to impose the duty of collecting the said Corporate Loans Tax on a foreign corporation without a resident treasurer in this State, the Supreme Court of the United States overruled the Pennsylvania Supreme Court and held that the tax could not be so imposed. See Commonwealth vs. New York, Lake Erie, and Western Railroad Co., 129 Pa. 463 and 153 U.S. 628. The Supreme Court of the United States has since departed from its strict interpretation of the constitutional limitation cited in the above case.

The language of the Corporate Loans Tax Statute also requires a foreign corporation to have a resident treasurer before its treasurer can be required to withhold the said Corporate Loans Tax and pay it over to the Department of Revenue. The Committee recommends that this section should be also amended to eliminate the words "resident treasurer", which should increase tax revenues.

Recommendation No. 10

The taxation of commercial banks and mutual thrift institutions should be placed on a uniform and equal basis and on as comparable a basis as possible with the taxable income of other corporations.

Recommendation 11

The Shares Tax on commercial banks and title insurance companies should be

replaced with an excise tax using the same income base and rate as is applied to thrift institutions. In addition, the deduction for federal income tax paid should be restored to the income tax base.

Financial institutions are taxed by the state in two different ways.

The Bank Shares Tax is levied at the rate of thirteen (13) mills on the actual value of shares of state and national banks, title insurance and trust companies located within the Commonwealth.

Actual value is ascertained by adding the amount of capital stock paid in and the amount of surplus and undivided profits, and dividing the result by the number of shares.

An excise tax of eleven and one-half percent (11-1/2%) is levied on net income of mutual thrift institutions (i.e., savings banks without capital stock, building and loan associations, and federal and state savings and loan associations).

In addition, private banks are taxed at one percent (1%) of gross receipts, but there are only a few such banks and the yield is inconsequential.

The above taxes are in lieu of the Corporate Net Income or Capital Stock Taxes.

State taxation of financial institutions has closely followed the development of federal legislation authorizing state taxation of national banks. This legislation is embodied in Sec. 5219, U.S. Revised Statutes (12 U.S.C. 548), which authorizes the states to (1) tax national bank shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such national banks on their net income, or (4) tax national banks according to or measured by their net income, provided that the imposition by a state of any one of these forms of taxation is in lieu of the others, except that a state may impose a tax measured by net income of the bank and also tax dividends of such banks in the hands of individuals.

However, from December 24, 1969 until January 1, 1972, additional state taxes on national banks are authorized, depending upon the location of the bank's principal office. A state may impose any tax that is imposed generally throughout the state on a nondiscriminatory basis on a national bank whose principal office is located in the state, but only to the same extent that the tax is imposed on state-chartered banks. States can not, however, tax intangible personal property of national banks except for the share tax as authorized by Sec. 5219. If the principal office of a national bank is not located in the state, the state may levy on the bank (1) sales and use taxes, (2) real property taxes, (3) documentary taxes, (4) tangible personal property taxes, and (5) various license, registration, transfer and excise taxes and fees imposed in connection with tangible personal property if levied throughout the state on a nondiscriminatory basis.

Effective January 1, 1972, the language of Sec. 5219 is eliminated and replaced with a provision that, for purposes of a federal or state tax, a national bank is deemed a bank organized and existing under the laws of the state or other jurisdiction within which its principal office is located (P.L. 91-156, Laws 1969).

The income base for the excise tax on mutual thrift institutions treats federal taxes paid as a deductible expense. It was reported to the Committee that of the twenty-odd states which impose an income tax on financial institutions, only one-half of the states allow a deduction for federal taxes paid. The Committee can find no justification for this distinction and hereby recommends its abolition.

The Committee believes that the taxation of <u>all</u> financial institutions should be on an income basis and that consistency of tax base should be sought between financial institutions and corporations generally.

Recommendation No. 12

The Gross Premiums Tax should be imposed on all insurance companies, without regard to whether the company is foreign or domestic, stock or mutual.

Recommendation No. 13

The Corporate Net Income Tax and the Capital Stock Tax should be imposed on all domestic insurance companies.

Recommendation No. 14

All domestic insurance companies which are subject to the Corporate Net Income Tax and/or the Capital Stock Tax should be allowed a credit to be applied against their gross premiums tax for the payment of these taxes.

Insurance companies doing business in Pennsylvania may or may not be subject to any one or a combination of the Corporate Net Income, Capital Stock or Gross Premiums Taxes. The Gross Premiums Tax is imposed at a rate of two percent (2%) of premiums written in the Commonwealth of Pennsylvania. The current application of these taxes to various insurance companies is shown in the chart attached hereto as Exhibit A.

You will notice from an inspection of the attached chart that domestic life insurance companies are subject to all three taxes, whereas domestic mutual fire and casualty companies pay none of the taxes. It should be noted that all foreign insurance companies pay only the gross premiums tax.

The Committee recommends that the taxation of all domestic life, casualty, fire, stock and mutual insurance companies be placed on a uniform basis. The Committee has found no justification for the discrimination in tax treatment between stock and mutual companies.

Furthermore, there is no justification for the imposition of both the Premiums Tax and general corporate taxes on certain companies.

Therefore, in order to equalize tax treatment among domestic insurance companies, the Committee recommends that all domestic insurance companies should be subject to the Gross Premiums Tax, Corporate Net Income and/or the Capital Stock Tax. The Committee, furthermore, recommends that the domestic insurance companies be allowed a credit against their Gross Premiums Tax for the payment of the Corporate Net Income and Capital Stock Taxes.

With regard to insurance companies which were not subject to the gross premiums tax, the Committee recommends that the gross premiums tax be phased-in in the following manner: one percent (1%) the first year and one-half percent (1/2%) for the next two years, resulting in the full imposition of the two percent rate after three years.

The Committee also considered an increase in the gross premiums tax from two percent (2%) to, at least, two and one-half percent 2-1/2%) or three percent (3%).

However, in light of the harshness of the retaliatory provisions of foreign states, the Committee decided not to recommend an increase in the Gross Premiums Tax.

Exhibit B included in this report shows a schedule of the tax treatment of domestic corporations recommended by the Committee.

It should be noted that the Committee has recommended no change with regard to the tax treatment of foreign insurance companies.

Recommendation No. 15

The Committee recommends technical amendments to the Gross Receipts Tax Act to limit credits for registration fees to non-Pennsylvania operators whose domicilliary states have reciprocal agreements with Pennsylvania.

The Gross Receipts Tax Act allows as a credit the total amount of registration fees paid to the Department of Revenue upon any motor vehicle or vehicles used in the business of carrying passengers or property for hire over the highways of this Commonwealth. Registration fees paid to states other than Pennsylvania are allowed the same credit to the extent that fees would have been paid to the Pennsylvania Department of Revenue if such vehicles had been registered in Pennsylvania, providing there are reciprocal agreements allowing such credit with the state or states in which the vehicles are registered.

The Legislature probably intended to assure Pennsylvania operators of motor vehicles that they would be accorded the same treatment with respect to tax credits in the domicilliary state of non-Pennsylvania operators. However, the statutory language results in a situation where non-Pennsylvania operators are encouraged to organize under the laws of a state that is not reciprocal to Pennsylvania and additionally in another state with which Pennsylvania is reciprocal. As a result of this 2nd registration, the foreign corporate taxpayer receives an unfair advantage, because he is given full credit for the payments made in the State with which we are reciprocal, even though his domicilliary state does not extend the same courtesy to our operators.

The Committee, therefore, recommends that language should be inserted in the Gross Receipts Tax Act of 1931 to limit the availability of credits for registration fees to non-Pennsylvania operators whose domicilliary states are reciprocal with the Commonwealth of Pennsylvania.

In addition, the Committee recommends that if the domicilliary state of a non-Pennsylvania operator is reciprocal with Pennsylvania, the amount of the credit should be limited to the fees that are actually paid for license tags, and not be tied to the amount of fee he would have had to pay in Pennsylvania. The payment of a nominal registration fee

to a division or department of the reciprocal state should not result in a large credit to reduce his Pennsylvania tax.

For example, situations have arisen where, under the laws of West Virginia, a motor truck company paid a nominal fee of an amount ranging from $1.00 to $10.00 which was claimed as a registration fee paid to that jurisdiction. Pennsylvania and West Virginia are reciprocal. By virtue of its payment of the nominal registration fee to a certain department of the State of West Virginia, the taxpayer claimed as a credit against the Pennsylvania tax in the amount of the registration fee or fees that it would have had to pay to the State of Pennsylvania had it registered the trucks in Pennsylvania. Pennsylvania would have a registration fee of several hundred dollars and the Committee believes the payment of a nominal $1.00 fee to West Virginia should not entitle the taxpayer to a credit of several hundred dollars.

The registration fee that the operator pays to the state of domicile must be equivalent to the registration fees payable by Pennsylvania operators to the Department of Revenue of this Commonwealth before a credit is allowed. The credit allowed for registration fees should be that which the taxpayer would have had to pay to the State of Pennsylvania but not in excess of the registration fees that the non-Pennsylvania operator paid to the state of domicile.

Recommendation No. 16

The Committee recommends technical amendment to give the Department of Revenue an additional one year to settle tax reports.

Section 801(b) of the Fiscal Code and Section 8(a) of the Corporate Net Income Tax both contain language which limits settlements by the Department of Revenue, as far as possible to the year succeeding the year for which the return was filed. (Emphasis added).

Many corporations obtain extensions until October 15 to file their tax returns and, consequently, the Department of Revenue has a very limited time (2-1/2 months) to examine the reports, and as a practical matter must accept the report as filed.

The Pennsylvania Supreme Court in the case of Commonwealth v. Safe Harbor Water Power Corp., 419 Pa. 497, and in subsequent decisions, has effectively read out of the statute the phrase "as far as possible".

In view of the statutory language and decisional law, the Committee recommends that the Department of Revenue be given an additional year to settle its tax reports, but with the additional recommendation that the resettlement period be changed from the current two year period to one year from the date of settlement.

EXHIBIT A

COMMONWEALTH OF PENNSYLVANIA
INSURANCE COMPANY TAXES

	Corp. Net Income (3)	Capital Stock	Gross Premium
Fire and Marine Ins. Cos. - Stock	T	T	E (1)
Fire and Marine Ins. Cos. - Mutual	E	E	E (1)
Hospital Corporations (Non-Profit)	E	E	E
Life Insurance Companies - Stock	T	T	T
Life Insurance Companies - Mutual	E	E	T
Limited Life Insurance Companies - Stock	E	T	T
Limited Life Insurance Companies - Mutual	E	E	T
Reciprocals or Inter-Insurance Exchanges	E	E	E
Title Insurance Companies	E	T (4)	E
Fraternal Beneficial Societies	E	E	E
Casualty Insurance Companies - Stock	T	T	E
Casualty Insurance Companies - Mutual	E	E	E
Employers Mutual Liability Insurance Associations	E	E	E
Medical & Osteopathic & Dental Service Corporations (Non-Profit)	E	E	E
Foreign Life, Fire, and Casualty Companies - Stock and Mutual	E	E	T (2)

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1. In lieu of Gross Premium tax, average three year marine underwriting profits attributable to premiums written in Penna. are subject to tax at 5%.

2. All taxes paid by foreign fire and casualty companies used for firemen's policemen's pension purposes.

3. Premiums substituted for sales in allocation formula.

4. 13 mills - same as bank shares tax.

EXHIBIT B

	Corp. Net Income	Capital Stock	Gross Premium
First and Marine Ins. Cos. - Stock	T	T	T
First and Marine Ins. Cos. - Mutual	T	E	T
Hospital Corporations (Non-profit)	E	E	T
Life Insurance Companies - Stock	T	T	T
Life Insurance Companies - Mutual	T	E	T
Limited Life Insurance Companies - Stock	T	T	T
Limited Life Insurance Companies - Mutual	T	E	T
Reciprocals or Inter-Insurance Exchnages	T	E	T
Title Insurance Companies	T	T	T
Fraternal Beneficial Societies	E	E	T
Casualty Insurance Companies - Stock	T	T	T
Casualty Insurance Companies - Mutual	T	E	T
Employers Mutual Liability Insurance Associations	T	E	T
Medical & Osteopathic & Dental Service Corporations (Non-profit)	E	E	T
Foreign Life, Fire, and Casualty Companies - Stock and Mutual	E	E	T(1)

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1 All taxes paid by foreign fire and casualty companies used for firemen's-policemen's pension purposes.

CAPITAL STOCK - FRANCHISE TAX

For more than a hundred years the Capital Stock Tax was the largest revenue producer among the Statewide taxes. Its relative importance has dwindled with the advent first of the Corporate Net Income Tax and later the Sales Tax but since it is estimated that it will yield over one hundred million dollars in revenue during the current fiscal year, it cannot be dismissed as unimportant. Because the process of arriving at valuation is so esoteric, however, a taxpayer's liability may rest in doubt for years pending disposition of a court appeal. Coupled with the ever-increasing cost of administering the tax and contesting disputes both on the part of the taxpayer and the Commonwealth, the uncertainty of liability makes the tax especially vulnerable to criticism. Certainty is a fundamental element of a fair tax and it is lacking entirely in the Capital Stock - Franchise Tax.

This is undoubtedly the most highly and frequently criticized tax in the entire State taxing structure and rightly so. Although nominally a tax upon the capital stock of a corporation, it has developed into one upon the actual value of a corporation. The governing statute, Act of June 1, 1889, P.L. 420, as amended has by judicial and administrative interpretation been braodened until establishing the valuation of a corporation has degenerated into a guessing game between the taxpayers and the Commonwealth's fiscal officers.

The chief criticism is that it is a judgment tax. While the governing statute does lay down general guideposts, it fails to furnish a method of arriving at a precise mathematical computation of stock value. In arriving at valuation, the statute provides that the following criteria must be taken into consideration:

First: The average which said stock sold for during the year;

Second: 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 the surplus or sinking fund; and

Third: The actual value indicated or measured by consideration of the intrinsic value of its tangible property and assets, and of the value of its good will and franchises and privileges, as indicated by the material results of their exercise, taking also into consideration the amount of its indebtedness.

Only the sales price of the stock may be computed with exactness and that factor in administration is given little weight. There is no indication of how the earnings and dividends factors are to be either capitalized or weighted. Finally the equity or net worth factor is not defined as precisely as might be desired. The vagueness has naturally resulted in myriad disagreements between taxpayers and the Commonwealth's taxing officials with the courts ending as arbiters in determining the taxpayers' valuation and liability. The courts have handled the problem on a case by case basis and have not attempted to provide a workable formula to guide the taxpayers. Indeed they may have even added to the ambiguity inherent in the statute by declaring in one case that all elements of value must be considered when they are present, including whatever may throw essential light on the subject.

As a result of the numerous court decisions, however, certain taxing practices have developed. Since the Department of Revenue has never issued official regulations to implement the statute, the so-called practices have been transmitted informally by word of mouth by former Commonwealth employees, accountants, attorneys and tax practitioners. Thus, it has become customary to capitalize earnings at ten per cent for all corporations other than utilities, whose earnings are capitalized at eight per cent. Dividends have been capitalized at eight per cent, with utility companies' dividends being capitalized at seven per cent. The "three-way" and "five-way" rules have developed. The former consists of an average of equity and current earnings and dividends capitalized and the latter of an average of equity and the current and five-year averages of earnings and dividends capitalized. No

official sanction has ever been given to any one method of arriving at valuation; hence, the taxpayer is at a loss in determining his tax liability year after year. The net result is that the tax has become a negotiated tax. The taxpayer submits its estimate of liability. The Commonwealth places its estimate of the taxpayer's liability. If the taxpayer disagrees with the Commonwealth's settlement (jargon for imposition of tax liability), it may pursue a two-stage administrative and two-stage court appeal procedure. The system obviously lends itself to favored treatment for some and to inequitable treatment for others. It may also lead to taxpayers questioning the integrity of taxing officials. And finally, it creates an atmosphere in which a taxpayer feels a compelling necessity to obtain expert guidance.

In addition to the uncertainty of tax liability, another criticism of the tax is the use of capitalization of income (and dividends when used) in arriving at valuation. It is argued that since corporations are also subject to a corporate net income tax, the use of earnings amounts to double taxation of corporate income. This criticism is especially relevant when corporations have little in the way of capital assets but enjoy large earnings through the efforts of key personnel.

Prior to 1935 Pennsylvania corporations and out-of-state corporations doing business in Pennsylvania were subject to the Capital Stock Tax on the same basis. An inequity resulted in that intangible assets of the foreign corporations escaped taxation even though they may have played an important part in the corporation's local business. In 1935, the Franchise Tax was enacted to apply exclusively to foreign corporations doing business in Pennsylvania. The entire valuation of such corporations was taken into account; however, a three-factor formula (property, payroll, and gross receipts) apportioned the value attributable to Pennsylvania to avoid unconstitutional taxation. Pennsylvania corporations continued to use a one-fraction factor to eliminate nontaxable assets such as property with a taxable situs outside

[illegible] The use of the different methods of

arriving at the proportion of taxable assets resulted in some Pennsylvania corporations being subjected to a heavier tax burden than competing out-of-state corporations so that effective with the taxable year 1968, the Legislature permitted Pennsylvania corporations the option of employing the three-factor formula to apportion valuation.

Historically, corporations engaged in manufacturing have been exempt from capital stock taxation upon that portion of their assets used exclusively in manufacturing. The avowed purpose of the exemption is to encourage new industries to locate in the State and the expansion of those already in the State, in effect to foster a favorable business tax climate. The concept of manufacturing has been extended by statute so that companies engaged in a variety of processing activities (and research and development) akin to manufacturing are also accorded the exemption.

RECOMMENDATIONS

The Committee recommends that the base of the tax be changed and made more certain by the use of a fixed-formula method of computation employing capital, surplus, and undivided profits.

Because it is impossible to predict exactly the impact of shifting to a more certain tax base, the Committee recommends a one mill increase from seven to eight mills on a temporary basis to assure stability of yield in revenue.

It recommends that the apportionment factors employed in the "Uniform Division of Income for Tax Purposes Act" be adopted for the Capital Stock-Franchise Tax with the exception of Section 16 b relating to the state of origin under certain circumstances in the allocation of sales of tangible property.

It recommends that the manufacturing, processing, and research and development exemptions be continued for the present; however, this exemption has been suspended for a time in the past when revenue needs dictated its suspension, and it is proposed that, should revenue needs so dictate, consideration be given to the suspension of this exemption.

It further recommends that all corporations be required to pay a minimum annual tax of One Hundred Dollars in order to help offset the rapidly increasing costs of administration.

TAXATION OF INTERSTATE BUSINESS

BACKGROUND

With the growth of the corporate business structure, the growth and mobility of our population and the ever-increasing need of the states for additional tax revenue; the states have looked to out-of-state business engaged in multi-state activities, deriving income in the states, to pay their share of such taxes. Aside from the need for additional revenues, the states have had two other objectives in imposing taxes on out-of-state business: (1) to prevent this ever-increasing tax burden from falling exclusively on state-based business concerns; and (2) require such out-of-state business concerns to assume their share of the tax burden, commensurate with the governmental protection that their in-state activities entitle them to receive.

Prior to 1959, the Supreme Court of the United States, on a case by-case basis, determined how far the states could go in taxing an out-of-state business. In a sweeping decision in the case of Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), the U.S. Supreme Court expanded the jurisdiction of a state to impose an income tax on an out-of-state business. Mr. Justice Frankfurter, wrote in a dissenting opinion that Congress ought to intervene and set up uniform standards of multi-state taxation under Congressional power to regulate interstate commerce.

With business, large and small, conducting business in more and more states and with an increasing number of states imposing all kinds of taxes on out-of-state business at ever-increasing rates, many multi-state taxpayers believed that they were facing an impossible burden of tax compliance in the various states. To them, this situation was compounded, not only by the diversity of state and local taxing

provisions under the same general tax structures, but also by the diversity in interpretation and administration of the same general statutory provisions.

Accordingly, as a result, in part, of the Northwestern decision and, in part, of the alleged impossibility of tax compliance in a multitude of states employing the so-called "market theory of tax jurisdiction", multi-state business appealed to the Congress.

In 1959, within months after the Northwestern decision, Congress declared a halt to the states' tax jurisdictional claim that merely furnishing a market in the states gave those states jurisdiction to tax. In that year, Congress enacted P.L. 86-272 (73 Stat. 555, 15 U.S.C. Sections 381-384), which provided that states and localities had no taxing jurisdiction to impose income taxes, measured by income, on an interstate firm; if the only business that firm engaged in the states was mere sales solicitation therein by its own employees. Such law also directed that the Committee on the Judiciary of the House of Representatives study the taxation of multi-state business concerns and propose permanent legislation concerning the same.

Such study was made and, as a result thereof, there was introduced in the 1965 Congress the Interstate Taxation Act (H.R. 11798), better known as the Willis Bill. This bill, as revised, became the basis for legislation passed in the House of Representatives in 1968 (H.R. 2158) and again in 1969 (H.R. 7906), better known as the Rodino Bill. Such bill would have further restricted state and local taxing sources by establishing federal jurisdictional standards for the imposition of state and local corporate net income, capital stock, sales and use and gross receipts taxes on multi-state business.

Prior to P.L. 86-272, the National Governors' Conference had been on record as opposing any legislation that would restrict the tax powers of state and local governments. Likewise, the National Legislative Conference had taken the same position. Thus, when the

Willis Bill was introduced, Governors and tax administrators across the nation, after examination of its provisions, expressed real alarm because they believed that such bill would either exempt multi-state businesses entirely from state taxation, narrow their tax base, make tax collections more costly or ineffective and cost the states dearly in revenue.

As a result of the introduction of the Willis Bill, the plan for a multi-state tax compact was created with the avowed purpose of suggesting workable uniform alternatives which would eliminate the need for the kind of Congressional action embodied in the Willis bill and other Federal bills that followed.

The provisions of such compact, which were worked out in 1966 by the Council of State Governments, Tax Administrators, Attorneys General and State Legislators, were presented to the states in January of 1967, and by July 1, 1970, the Multi-State Tax Compact had been adopted by 20 regular-member states and 12 states, including Pennsylvania (by Governor's Executive Order), had become associate members.

In addition to the Multi-State Tax Compact, there has been introduced in the Senate by Senator Magnuson, S. 2804 (known as the Consent Bill). This bill, which was drafted by the Council of State Governments and the Advisory Commission on Intergovernmental Relations, contains the Multi-State Tax Compact provisions and would grant consent to the Multi-State Tax Compact. It further provides, among other things, that if all states have not adopted the Multi-State Tax Compact by July 1, 1971, such non-adopting states must, nevertheless, offer the multi-state firms the compact option of using the three-factor formula (payroll, property, receipts) in determining the share of their income that is apportioned and subject to taxation by a state.

THE MULTI-STATE TAX COMPACT

The generally stated purposes of the Multi-State Tax Compact are "to facilitate proper determination of state and local tax liability, to promote uniformity or compatibility of tax systems, to facilitate the multi-state taxpayers convenience and compliance regarding taxing procedures, and to avoid duplication of taxation." More specifically, but in outline form, the Compact would:

1.) Give a taxpayer the option of utilizing the Uniform Division of Income for Tax Purposes or other allocation or apportionment rules which are in effect in a state. The Uniform Division of Income concept will be discussed fully below.

2.) Give small taxpayers (those engaged only in making $100,000 or less per year in sales in a state) the additional option to use a short form return in lieu of a detailed computation of income tax liability. This provision does not expand the income tax jurisdiction of the states. The Compact actually incorporates existing tax jurisdictional rules which presently require collection of taxes based on selling activities only where a firm regularly and systematically solicits business in the state through use of salesmen who are physically present therein.

3.) Give taxpayers an additional option to utilize existing procedures for resolution of multi-state tax matters or alternately, to utilize a tax arbitration procedure which is designed to provide quick, fair and efficient resolution of such matters and eliminate any possibilities of double taxation. The Compact, however, does not require any taxpayer to use the arbitration procedure.

4.) Provide a sales and use tax credit provision which would be in accord with action already taken by most of the forty-six sales and use tax states.

5.) If a state desires, participate in a program of cooperative audits, thereby reducing the number of audits to which taxpayers might be exposed.

6.) Create an administrative arm for the Compact, a Commission made up of representatives of each state. The Commission, with the counsel of local government and business and consumer advisory groups, would conduct studies designed to achieve simplicity, uniformity and equity in multi-state tax matters and would also issue advisory rules and regulations to be adopted by states having uniform tax laws.

UNIFORM DIVISION OF INCOME

As previously noted, the Multi-State Tax Compact grants a taxpayer the option to utilize the three-factor formula of the Uniform Division of Income for Tax Purposes Act in allocating his income among the various states for tax purposes. This Act was drafted and approved by the National Conference of Commissioners on Uniform State Laws and is presently available for use by taxpayers in 27 of the 41 corporate income tax states. While the Uniform Act is substantially similar to the three-factor formula presently in use in Pennsylvania under the corporate net income and corporate income taxes, the sales or gross receipts fraction of Pennsylvania's Corporate Net Income Tax varies significantly from the Uniform Act.

For example, under the Pennsylvania Corporate Net Income Tax, the so-called "headquarters", not destination, standard is used in determining which sales will be included in the numerator of the Pennsylvania sales fraction. Statutorily then, sales are attributed to

Pennsylvania only if the salesmen making the sales operate from headquarters located in Pennsylvania. The net effect is that many sales actually involving negotiation of the contract or delivery of the goods in Pennsylvania have not been included in the Pennsylvania sales fraction because companies have managed to attribute them to sales made by salesmen connected to "offices" or "headquarters" not located in Pennsylvania.

While enactment of the Compact alone would give the taxpayer the option to use the destination sales fraction contained in the Uniform Act under which sales are attributable to the state in which ultimate delivery of the goods to the purchaser occurs, such option would really not have any impact on Pennsylvania law, either by way of extensive utilization of such option by a taxpayer or the shifting of significant revenues. The reason is that some Pennsylvania companies making substantial deliveries of goods to Pennsylvania purchasers have for many years, as previously noted, utilized the out-of-state "dummy headquarters" (perhaps in a state not having a corporate tax measured by income or one where the sales factor is allocated on a destination basis), in which case such sales are not included in income allocated to and taxed in Pennsylvania. There is no question that use of such "pseudo headquarters" by some companies has not only been a successful tax avoidance measure, but such utilization over the years has meant, perhaps, a substantial loss of tax revenues to Pennsylvania.

However, if Pennsylvania followed the lead of other states which have adopted the Uniform Division of Income for Tax Purposes, then generally destination, not "headquarters" would be the basis for allocating sales in or out of Pennsylvania.

The Uniform Act in general, and its sales factor in particular, are designed to: (1) eliminate ambiguities such as those now existing in Pennsylvania's gross receipts fraction; (2) achieve a more equitable measure of business activity within a state; (3) reduce tax

administrative and compliance costs; (4) eliminate the possibility of double taxation; and (5) facilitate achievement of full accountability by eliminating technical tax avoidance schemes.

Section 16 (a) of such act sets forth a "physical delivery of the goods" destination rule to be used in assigning sales to the numerator of the sales fraction. It thereby minimizes manipulation of the assignment of sales by making irrelevant the technical question of where the f.o.b. point is designated.

However, Section 16 (b) of the act also provides, in part, that sales of tangible personal property are included in the numerator of the fraction in the state of origin if shipped from an office, store, warehouse, factory or other place of storage in such state to an out-of-state destination in cases where the taxpayer is not subject to the tax jurisdiction of the state in which the goods are delivered. This full accountability rule of Section 16 (b), more commonly referred to as the "throw-back rule", applies when sales are made to the Federal Government or the state to which the goods are shipped does not have a corporate tax measured by income or the taxpayers' activity in the destination state is so minimal that such state under P.L. 86-272 does not have jurisdiction to impose a tax measured by income on such taxpayer.

The committee has studied with great interest the controversy between corporate business and state tax administrators over this "throw-back" rule.

Corporations argue, on the one hand, that if a state employs a "destination" rule, then it should uniformly be applied to all sales; that is to say, if it is delivered in the state, then such sales should be in the numerator of the sales fraction and allocated to such state, but if it is delivered outside the state then it should not be included in the numerator of the origin state merely because the taxpayer delivering such property to an out-of-state location is not subject to corporate tax on income in the destination state. The business concerns reason that under a destination rule, it should be of no concern of the state from which

the goods are shipped as to whether or not the taxpayer is subject to tax in another jurisdiction and, to apply a different rule lacks uniformity and is grossly unfair to the taxpayer. Advocates of the full accountability concept (throw-back) argue, on the other hand, that, since the enactment of a broad tax jurisdictional exemption in P.L. 86-272, a full accountability rule such as contained in Section 16 (b) of the Uniform Act is necessary. They claim that, if the full accountability rule is not followed, large firms could immunize their sales activities from practically all accountability for state taxes merely by concentrating their production and warehousing activities in a few states and limiting their selling activities in the remaining states to the "solicitating salesmen", "missionary men", or independent contractors which activities in such states would not make such firms subject to the corporate tax or such states under P.L. 86-272.

As far as the present law of Pennsylvania is concerned, the employment of the "throw-back" rule is meaningless for two reasons. First, if a foreign corporation located in a state such as Ohio, having no corporate net income tax, ships goods into Pennsylvania as a result of minimal activities, which under P.L. 86-272 denies jurisdiction to Pennsylvania to impose a corporate net income tax, then Pennsylvania receives no tax, even though it had the "destination" concept in its law. Second, under the present "headquarters" concept in our law, the "throw-back" rule usually has no relevancy since income from goods sold and delivered in Pennsylvania by a Pennsylvania corporation, or even a foreign corporation subject to the Pennsylvania Corporate Net Income Tax, are not generally being included in the numerator of our State's sales fraction because such sales have been negotiated at or generated by salesmen connected with "headquarters" outside the State.

The Committee believes the Multi-State Tax Compact is the right approach to solving the problems of taxation of interstate business, rather than federal legislation which, in effect, seems to declare that the solution of multi-state tax problems is hopeless and seeks

to minimize their impact by curtailing state and local taxation. While interstate taxpayers might be eager to secure preferential tax treatment from such a federal taxing system since they would, in many instances, receive a windfall, the consequences for their non-exempt competitors and Pennsylvania revenues could be disastrous. It has been estimated that the enactment of a provision similar to that contained in the Rodino Bill would mean a loss in our State revenues of anywhere from 80 to 100 million dollars. If such is the case, non-exempt intrastate firms in our business community might be faced with the possibility of increased tax burdens in order to make up the revenue losses resulting from federally-required preferential exemptions granted to interstate business.

In addition to the adoption of the Compact, the Committee firmly believes that the "headquarters" concept should be eliminated from the corporate tax laws and replaced with the Uniform Division of Income Tax Act which contains therein the "destination" basis concept. The enactment of such Uniform Act, the main purpose of which is to avoid multiple inclusion by the states of the same sales in the numerators of their respective sales fractions, might forestall further Congressional action if a leading industrial state like Pennsylvania and other states will adopt the Uniform law. In addition to uniformity, a destination concept would bring simplicity and ease of administration of the sales factor and thus avoid costly and excessive litigation. However, the Committee also believes that in the assignment of sales of tangible personal property to Pennsylvania under the "destination" rule, uniformity, simplicity, equity and fairness dictate that it should be on a "straight" destination concept and not a dual concept, i.e. one being the "state of destination" and the other the "state of origin" exception found in Section 16 (b) of such Act which provides that sales would be assigned to Pennsylvania if shipped from Pennsylvania to a destination outside our State where the corporate taxpayer is not taxable in the state of purchaser, because of P.O. 86-272 or because such state has no tax, or where the purchaser is the Federal Government. Aside from uniformity or equity, the

Committee thinks it unwise to assign sales on an origin basis, since such would be inconsistent with Pennsylvania's effort to promote economic growth through the encouragement of new or expansion of existing warehousing facilities in this Commonwealth. Therefore, if the Legislature adopts the Uniform Division of Income Act it ought to exclude the "state of origin" exception of Section 16 (b) of such act for the reasons stated above.

The Committee recommends also that, though the Pennsylvania Corporation Income Tax already uses a "destination" sales fraction in allocating income, substantial ambiguities appear to have arisen and it would, therefore, be desirable in the interest of tax simplification and equity to amend the language of such act to conform to the allocation formula contained in the Uniform Division of Income for Tax Purposes Act, but without such exception. Likewise, the Capital Stock and Franchise Tax should be amended in the same manner, with the proviso that the "state of origin" exception found in Section 16 (b) of the Uniform Act should not, as previously noted, be included in the amendment made to such corporate tax acts.

RECOMMENDATIONS

The Committee recommends that the Legislature enact the Multi-State Tax Compact so that the Commonwealth of Pennsylvania may join with other members of the Multi-State Tax Commission in seeking ways to properly determine state and local tax liability, to promote uniformity or compatibility of tax systems, to provide convenience to interstate business in complying with taxing procedures and to avoid duplication of taxation.

The Committee recommends further that the "headquarters" concept utilized under the Corporate Net Income Tax in the allocation of income of an intersrate business to Pennsylvania be replaced with a destination concept through the enactment of the "Uniform Division of Income for Tax Purposes Act", as drafted by the National Conference on Uniform

State Laws; but omitting therefrom paragraph "b" of Section 16 of such Act relating to allocation to state of origin under certain circumstances.

The Committee recommends that for purposes of uniformity the allocation under the Corporate Income Tax and Capital Stock and Franchise Taxes also be amended to conform to the Corporate New Income Tax as contained in the previous recommendations.

PERMANENT TAX REFORM ADVISORY COMMITTEE

As previously noted, the Committee has made recommendations on the State and local tax structure within the time limits available to it. There are many areas where a still more exhaustive study in necessary, such as in the utility real estate tax field,[1] senior citizens tax relief,[2] and local real property taxes, in order to achieve a sound, progressive and equitable State and local tax system. Accordingly, our recommendations for change should be considered merely a starting point, not an end to tax reform. The Committee recommends that there be created a permanent joint House and Senate Tax Reform Advisory Committee which would have the duty and responsibility, on a continuing basis, to recommend to the Legislature various ways in which the State and local taxes could be amended to further provide a sound and progressive tax structure responsive to public needs within the Commonwealth of Pennsylvania.

1. The Joint State Government Commission has recently completed an extensive study of the taxation of public utility real estate. This study was placed in the hands of the Committee only a short time prior to the conclusion of its labors and it was flet that the Committee would not have an adequate opportunity to digest and evaluate the findings and recommendations of the Joint State Government Commission, or to make independent findings and recommendations. Rather than attempt to undertake such a complex and difficult area of study as this in a limited time, the Committee concluded that the subject should be referred to the recommended Permanent Tax Reform Advisory Committee.

2. Senior citizens' tax relief. In the course of its work, the Committee has considered several plans for tax relief for senior citizens with low incomes. The plans considered were not adopted because it was felt that they lacked the basic equity and relief which was desired in this area. It is strongly recommended that the Permanent Tax Reform Advisory Committee undertake the necessary research and study to develop a feasible tax plan for equitable tax relief for our senior citizens. In the meantime, the Committee recommends the prompt enactment of legislation similar to House Bill No. 103, which will, in our judgment provide interim tax relief for senior citizens. Further, it should be noted that under the recommended state income tax plan, senior citizens will receive substantial tax relief, because both the tax base and the additional tax credit are based upon the federal deductions allowable for age, independency, and blindness.

3. This area of taxation has a long, detailed and technical history which, for its complete understanding, requires an extremely comprehensive study. The Committee has conducted preliminary research and has consulted with experts in this field. In addition, Representative John C. Pittenger has made preliminary explorations of this tangled matter. Unfortunately, in the time available to the Committee, we were unable to resolve the many difficult and complex problems involved, and accordingly, it is recommended that the matter be referred to the Permanent Tax Reform Advisory Committee.