New Jersey - 179th Legislature - Sale of Land to Volunteer Fire Companies - Leases

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LEGISLATION

NEW JERSEY—179TH LEGISLATURE—SALE OF LAND TO VOLUNTEER FIRE COMPANIES—LEASES.*

I.
INTRODUCTION.

Recently the New Jersey Legislature enacted a law authorizing municipalities to convey lands, for which there no longer exists an essential public purpose, to duly incorporated volunteer fire companies, at a nominal fee. The favored companies are then to erect suitable fire houses or fire schools. Acts such as this have seldom failed to escape examination under the state constitutional prohibitions concerning the donation of land or money by a municipality to any association, society, or corporation. It is the purpose of this paper to examine the act in the light of these restraints.

* SALE OF LAND TO VOLUNTEER FIRE COMPANIES—LEASES

CHAPTER 127
SENATE, No. 37

An Act to amend "An act concerning the sale of land by municipalities to volunteer fire companies, and supplementing chapter 60 of Title 40 of the Revised Statutes," approved July 15, 1954 (P.L.1954, c. 143).

Be it enacted by the Senate and General Assembly of the State of New Jersey:

1. Section 1 of the act of which this act is amendatory is amended to read as follows:

1. When the governing body of a municipality shall determine that any land owned by the municipality is no longer desirable, necessary or required for public purposes, it may by resolution authorize the sale and conveyance of the same for a nominal consideration to a duly incorporated volunteer fire company of the municipality, for the erection thereon of a fire house or for the erection thereon of, or the use thereof including any buildings thereon as, a fire school.

Any such land including any buildings thereon sold and conveyed to any duly incorporated volunteer fire company may be leased by such fire company to any volunteer firemen's association for the erection thereon of, or the use thereof as, a fire school for the benefit of the members of such association.

2. This act shall take effect immediately.

Approved and effective July 11, 1955.


2. N.J. Const. art. VIII, § 3, para. 2: "No county, city, borough, town, township or village shall hereafter give any money or property, or loan its money or credit, to or in aid of any individual, association or corporation, or become security for, or be directly or indirectly the owner of, any stocks or bonds of any association or corporation." N.J. Const. art. VIII, § 3, para. 3: "No donation of land or appropriation of money shall be made by the state or any municipal corporation to or for the use of any society, association or corporation whatever."

(138)
II. CONSTITUTIONAL INTENT.

With the arrival of the nineteenth century, the United States witnessed a feverish expansion in the development of its systems of transportation. Not infrequently this growth was prompted by a manifest willingness of the part of the states to support such ventures. Eventually, what had originated as a promising state policy, became an imminent threat to its economy. Delegates to the New Jersey Constitutional Convention of 1844 were keenly aware of the dangers which too frequently accompanied such subsidization. To prevent a similar occurrence, a provision, denying the state any authority to extend its credit, was included. With the electoral amendments of 1875, which enlarged the prohibition concerning donations and appropriations in support of private enterprises so that it included counties and municipalities, a sound lock appeared to have been applied to the door of the treasury. The New Jersey constitution, revised in 1947, has incorporated these articles verbatim.

III. CONSIDERATION.

Though important problems were solved by these provisions, others of perhaps equal importance arose. Courts, faced with the frequent invocation of the donatary articles, searched industriously into issues to uncover benefits accruing to the state or the municipality which would obviate the necessity of declaring a law unconstitutional. The payment of a moral obligation, incidental to the state's educational program was adjudged not violative. Compensation for services rendered a municipality in the transportation of county officials and police officers was held a cost item of police protection, and therefore not within the constitutional prohibition. Statutes authorizing the purchase of a water company, or an addition thereto have withstood the test of constitutionality. Further, the granting of pensions to retired police officers has been held a binding obligation, and an

3. 2 Lincoln, Constitutional History of New York, 80, 81 (1906).
4. Proceedings, New Jersey Constitutional Convention 1844, 64.
5. N.J. Const. art. XIX, para. 19 (as amended by election of 1875); N.J. Const. art. XIX, para. 20 (as amended by election of 1875).
inducing cause of the claimant's entry into the city's employ.11 A statute which authorized a compromise of taxes, however, met with opposition in these articles,12 which have been held to prohibit indirect as well as direct support to private corporations.13 The preceding, and other cases evince a marked similarity in that the expenditure of public funds, questioned in each, has found justification in a recognized moral, legal, or equitable obligation on the part of the municipality.

IV. PUBLIC PURPOSE.

More indicative of the seemingly inherent flexibility of the donatary articles, is the readiness of the judiciary to apply the public purpose test to what would, on its face, seem doubtful legislation. An explicit manifestation of this frequently utilized test14 is found in the case of Lynch v. Borough of Edgewater.15 The court held that the determination of whether a statute violates the constitutional provision prohibiting the donation of public money to private individuals depends upon whether the statute in question was enacted for a private or a public purpose. Statutes evincing a causal or substantial relationship to the public welfare present little difficulty in issues involving the constitutionality of municipal contributions. Expenditures for housing,16 highways,17 port improvement,18 libraries,19 and the protection of personal and property rights20 have all withstood inquiry into their constitutionality in the form of the public purpose test. In Trustees of Free Public Library of Newark v. Civil Service Commission of New Jersey, Vorhees J., observed:

"To justify the donation of public moneys, it seems necessary to regard these organizations as public agencies of the state, created by it

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15. 8 N.J. 279, 85 A.2d 191 (Sup. Ct. 1951).
in connection with its municipalities and as an incidental part of their government." 21

The introduction and development of this test within the courts has done much to clarify the meaning of these provisions. It would not be incorrect to conclude that it has been instrumental in the accrual of numerous benefits to the community. But such a test, involving as it does, questions of degree, is not immune from criticism, particularly as to what limits the courts will endure. 22 This is especially relevant in view of the "nominal consideration" clause in the instant statute when read in conjunction with the statement of Case, J. in the case of Jamouneau v. Local Board of Division of Local Government in State Department of Taxation and Finance:

"When we say give away we refer to the legal conception of a clear and substantial deficiency in consideration for giving up a source of city revenue, even though the deficiency may not have been perceived by the city when the resolution was adopted and became demonstrated only on the review." 23

V.

CONCLUSION.

An examination of the decisions on the issue of state and municipal contributions and extensions of credit reveals that courts have most frequently focused their attention upon the purpose of the recipient or the authorizing statute, and then have drawn their conclusions as to the constitutionality of the law. Thus it appears that the existence or the extent of control exercised by a municipality over a particular volunteer fire company is of slight moment, since the evident public purpose involved should provide ample justification for the conveyance of land at a nominal fee.

John J. Collins

PENNSYLVANIA LEGISLATION—1955 SESSION—
CLASSIFIED INCOME TAX BILL.*

THE PENNSYLVANIA CONSTITUTION AND STATE INCOME TAXATION.

For many years the legislature of the Commonwealth of Pennsylvania has been struggling without success with the income tax problem. On the few occasions when they passed such legislation, their efforts have been


* See Appendix A.
declared unconstitutional by the judicial bodies of the state. The income tax problem was recently brought into the foreground when the Classified Income Tax Bill, supported by Governor George M. Leader, met a hasty death at the hands of the State Senate. While the proposed tax measure thus escaped formal judicial attention, efforts to tap new sources of revenue are ever-continuing, and it is to be expected that legislation aimed at taxing the income earned by individuals will be introduced again in the near, if not immediate, future. With this thought in mind, the relevant provisions of the state constitution will be examined as well as past judicial decisions on income tax legislation, in an effort to determine: (1) the skeleton form of an income tax provision that would meet the requirements of the state constitution, and (2) whether the proposed taxing measure co-sponsored by House Majority Leader Readinger and Representative Breth would have successfully hurdled the constitutional barrier, had it met with approval in the State Senate.

I. CONSTITUTIONAL LIMITATIONS.

A. Subject Matter.

The term "income" may be refined by the use of the modifiers, "gross" and "net." The former refers to an all-inclusive concept of income, while the latter refers to the amount remaining after deducting from the gross income figure the necessary expenses incurred in the realization of this gross income. While the popular concept of income taxation refers to the levying of a tax on the net income figure, this concept must be examined in the light of the limitations of the Pennsylvania constitution to determine whether or not "net income" may be the proper subject of revenue-procuring legislation in the Commonwealth.

The pertinent section of the state constitution reads: "All taxes shall be uniform . . .," and this phraseology has been interpreted to encompass the entire field of taxation. Certainly, gross income is a proper subject of taxation, as each party is taxed on what he has earned "in toto," and uniformity would be present, insofar as the subject matter alone is concerned. However, when considering the term net income, it must be recognized that different parties who earn the same amount (gross income) may pay different taxes on this amount due to the difference in deductible expenses that each might have. In a technical sense, this point would appear to show a non-uniform taxing measure that would necessarily be

unconstitutional, for it is the uniformity of the tax in application, rather
than the mere uniformity of the taxing law that is demanded by the
constitution. 5

Looking to present-day income taxation in the Commonwealth, one
finds the Corporation Income Tax Law, 6 the Corporation Net Income Tax
Act, 7 as well as various local ordinances which tax the income of individuals
through the mechanism of the Sterling Act. 8 Typical of the latter group
is the tax imposed on “salaries, wages, commissions and other compensa-
tion” by the City of Philadelphia. 9 This ordinance replaced a prior enact-
ment 10 which contained exemption clauses. The judiciary found the ex-
emption clauses to be unconstitutional, 11 but relied on the saving clause
to preserve the remainder of the ordinance. However, the enactment was
then immediately repealed 12 and replaced by the present wage tax. 13 The
inference to be drawn from these decisions is that “net income,” as we
have defined the term (gross income minus the necessary expenses in-
curred in the realization of that income), is a proper subject of taxation
under the Pennsylvania constitution; for, while it is true that exemptions
were not permitted, net profits were taxed in those areas of business ac-
tivity that demand cost expenditures. Thus, it would appear that the
Philadelphia ordinance taxes the gross “take-home” pay of the individual,
which comes within our definition of “net income.” One problem present
in any discussion of the wage tax is that a working man’s deduction for
the necessary expenses incurred in the attainment of his gross income is
not found in the ordinance, and yet the collection regulations allow this
practice. 14 However, this problem properly comes under the heading of
classification problems, which will be discussed separately in this Comment.
In discussing these expenses reference is not made to commutation costs,
and items of that nature, which have been thoroughly examined by the
federal courts, but rather reference is made to such “required” expenses as
union dues.

The state-imposed taxes on the net income of corporations further
confuse the issue. While the Corporation Net Income Tax Act states
that it is an excise tax, 15 not all courts have so interpreted it. One theory
proposed is that the tax is an excise tax on corporations for the privilege

14. 2 CCH STATE TAX REPORTER (Pa.) ¶ 73-051a (1954).

http://digitalcommons.law.villanova.edu/vlr/vol1/iss1/16
of doing business in Pennsylvania, and that the net income figure is used merely as a base for the application of this levy. This might well be called the "Dauphin County" view. The opposing view is encountered in the cases supporting the validity of the Philadelphia Mercantile Tax, which is a result of the Sterling Act. In order to uphold the constitutionality of the mercantile tax, the court had to hold that the Corporation Net Income Tax act was a property tax, since if the latter was found to be an excise tax, the mercantile tax would be void because of the mandatory pre-emption provisions of the Sterling Act which prohibit duplication of subject matter of taxation between the state and the municipality.

The Corporation Income Tax Act states in its provisions that it is a property tax on net income. However, little weight is given these statements which are used to preserve constitutionality. If it were considered to be an excise tax it would violate the federal constitution since its scope is so broad that it could tax a foreign corporation for the privilege of engaging in interstate commerce. The question of whether this tax is a property tax has not been litigated. In the only reported case testing the application of the act, the Supreme Court of Pennsylvania reversed on the federal ground the lower court ruling that the tax was assessable on the petitioner. Hence the court did not have to decide whether the tax was a property tax or an excise tax. In the light of this decision it would appear that a revenue measure levied on net income in the nature of a property tax would be constitutional. The uniformity provision would be satisfied since all those subject to the tax would be taking the same steps in ascertaining the amount on which the tax would be levied, namely, gross income less expenses incurred in the realization of this income. If this is true, a fortiori, a tax assessed on gross income would be constitutional.

While the classification basis of the Philadelphia Wage Tax as such has never been litigated such differentiation might well be found unconstitutional. This tax is assessed on total (gross) salaries, commissions, wages and other compensation, but on net profits. While the rationale may be that the tax is levied on gross take-home pay, this is not necessarily carried out by the tax, since union dues and other absolutely necessary business expenses to a salaried worker are not deducted from his total wage.

21. Ordinance of the Philadelphia City Council, 656, 658. Approved December 13, 1939. Though the constitutionality of the classification has never been litigated, the classification was held reasonable with regard to the fact that the ordinance went into effect one year earlier on salary workers than on net profits. Dole v. Philadelphia, 337 Pa. 375, 11 A.2d 163 (1940).
figure in arriving at his taxable figure. However, it may be properly argued that this apparent differentiation is not real. Although the act itself does not provide for the deduction of necessary expenses by the working man, the collection regulations do so provide. Thus, in application, the treatment is equal.

B. Requirement of Uniformity.

The Pennsylvania constitution states without exception that all taxes levied through the power of the General Assembly must be uniform upon the same class of subjects. While it is a recognized fact that absolute equality in taxation is not attainable, nevertheless, uniformity of rates and mechanism of assessment must be present in order to satisfy the requirements of the constitution. Uniformity of taxes in application is required by the constitution, rather than mere uniformity of the provision. To illustrate this point it is worthwhile considering a tax that has uniform provisions, and yet is unconstitutional because these provisions, in their application, do not assess the levy in a uniform manner, either because a deduction is given one class, or because another group receives an exemption. Non-uniformity, as the term is understood in a taxing sense, may be present in a revenue measure in any one of several ways. It may occur by allowing exemptions in tax legislation other than those permitted by the constitution of the Commonwealth; the violation of the uniformity provision may occur where there is a feigned system of classification or where the revenue measure is not uniform in its fundamental rate application. We will discuss each of these topics separately.


While exemption clauses in revenue measures might seem to be an entirely separate topic, due to the wording of the Pennsylvania constitution they are so interwoven with the concept of uniform taxation as to demand joint treatment. Not only does the constitution set forth the property that may be exempted from taxation by the Commonwealth, but

22. See note 21 supra.
23. 2 CCH STATE TAX REPORTER (PA.) ¶73-051a (1954).
24. PA. CONST. art. IX, § 1 (1923).
28. PA. CONST. art. IX, § 1 (1923); PA. CONST. art. IX, § 2.
31. PA. CONST. art. IX, § 1 (1923); PA. CONST. art. IX, § 2.
it states that, "All laws exempting property from taxation, other than the above enumerated shall be void." The courts of Pennsylvania have dealt strongly with all revenue legislation containing provisions exempting property which cannot be classified under the specific constitutional exemptions. The Income Tax Act of 1935, which exempted individuals who earned less than a stated net income, was declared unconstitutional. Another legislative enactment, which exempted certain privately held lands from taxation, met the same fate. This act afforded a property owner the opportunity to qualify his property as state forest land, thus reducing his assessment valuation to one dollar an acre. A taxing statute of 1885, which proposed to exempt income received from bills, notes and labor done, had this provision deleted by the court, though the remainder of the act was declared constitutional. In a more recent decision, the judiciary deleted a deduction clause and a provision extending an exemption from the 1938 Philadelphia Ordinance taxing net income. The remainder of the ordinance was upheld because of this saving clause but the City Council immediately repealed the ordinance. The only situation, apparently, where an exemption clause outside the wording of the constitution has been allowed occurred when the revenue law existed before the passage of the present constitution. Even in this situation, however, the policy against exemptions has been voiced. Clearly, then, as the constitution now reads, any and all exemption and deduction clauses that cannot be made to fit into the specified exemption classifications of the constitution are illegal.

2. Classification.

The constitutional requirement of uniformity demands a true and honest division of classes, where such classes are to be taxed in a different

32. PA. CONST. art. IX, § 2. "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws; but the General Assembly may, by general laws, exempt from taxation public property used for public purposes, actual places of religious worship, places of burial not used or held for private or corporate profit, institutions of purely public charity, and real and personal property owned, occupied, and used by any branch, post, or camp of honorably discharged soldiers, sailors, and marines." PA. CONST. art. IX, § 1 (1923).
33. PA. CONST. art. IX, § 1 (1923).
37. Fox's Appeal, 112 Pa. 337, 4 Atl. 149 (1886).
41. An earlier opinion, based on similar facts, held that while the legislature should be given some time to adjust the legislative changes in the tax system caused by the passage of the constitution, the new constitution prohibited all exemptions other than those specified in the uniformity provision regardless of when the particular statute went into effect. Lehigh Iron Co. v. Lower Macungie Township, 81 Pa. 482 (1876).
manner. Where the classification of subjects presented by the taxing law does not meet this standard, the tax is unconstitutional as it fails to meet the uniformity requirement of the constitution. It has been held that a pretended classification which is based solely on the difference in quantity of precisely the same kind of property, is necessarily unjust, arbitrary, and illegal.

The courts have found that bituminous and anthracite coal may be classified differently, as may foreign and domestic insurance companies, and corporate and individual debts. Surely, these decisions give the reader no concrete guide as to what type of decision to expect in the future. The line of permissive classification is drawn fine in many cases, and the courts rely on factors like the chemical make-up of the product, its system of refinement, or its use to reach their conclusion. The courts state that it is a recognized fact that in arranging a scheme of classification as a basis for taxation, the legislature may properly consider the purpose behind a given set of circumstances and make the existence of such purpose the controlling element in determining tax liability.

"Classification is not necessarily based on any essential difference in the nature, or, indeed, the condition of the various subjects; it may be based on the want of adaptability to the same methods of taxation, or upon the impracticability of applying to the same subjects the same methods, so as to produce just and reasonably uniform results, or it may be based on well-rounded considerations of public policy."

Under the Corporate Net Income Tax Act, as amended in 1947, the distinction between being taxed at one rate or another was the date of resettlement of carry-back losses of previous years. The supreme court held that this was a differentiation based on an unjustifiable classification. Yet, while one might readily accept the court's finding in this instance, is there a real distinction for the purpose of complying with the uniformity requirement between anthracite and bituminous coal? To go still further into the issue, would the court have held that one type of coal could be taxed and another not taxed? This apparently was the case in the corporate field where the Corporate Net Income Tax Act preceded the Cor-

43. In re Cope's Estate, supra note 42.
50. PA. STAT. ANN. tit. 72, 3420b (Supp. 1954).
poration Income Act by nearly twenty years. The latter taxes corporations concurrently with the former, and the problem of classification when raised today is answered by the statement that both statutes tax at the same rates. This answer would seem to admit that for the time period when the Corporate Income Tax did not exist, all corporations were not uniformly taxed, since some corporations that were taxed under the second act were not taxed by the first act. The sophisticated reasoning of the courts in this area is usually prompted by the various municipal wage taxes, of which Philadelphia's is typical.\textsuperscript{52} Here a distinction is made between "wages, salaries, commissions and other forms of compensation" and the "net profits" of a business or profession. The latter are taxed on the "net" figure, the former on the "gross" figure. The only possible rationale for this apparent diversity of treatment is that the authors of this measure wanted to tax the "gross take-home" of the wage earner. This would seem to be the case, inasmuch as the collection regulations allow wage earners a deduction for moneys expended in the attainment of gross income in the computation of taxable income. This last-mentioned fact is a practical offshoot of the \textit{purpose} doctrine as outlined above, and at the same time, it serves to point out the vagueness and inconsistency that surrounds the courts' reasoning on classification and the uniformity clause.

3. \textit{Uniformity of Mechanism}.\textsuperscript{53} The uniformity provision of the Pennsylvania constitution\textsuperscript{54} demands that taxation be applied by a uniform taxing mechanism on the same class of subjects. This is most clearly illustrated by the case of \textit{Kelley v. Kalodner},\textsuperscript{55} which declared the graduated income tax act of 1935 unconstitutional. The court stated that a revenue provision levying a tax on the net income of individuals at varying rates, according to income classification, though the rates may be reasonable in themselves, violates the uniformity provision of the constitution. It has thus been established in Pennsylvania that a tax imposed at different rates upon the same type, or classification, of property, on the basis of quantity involved, offends the uniformity clause.\textsuperscript{56} Thus, it is apparent that the uniformity provision of our state constitution demands a single fixed procedure for the taxation of each classification of subject matter. The question of whether or not a classified income tax would fit within the constitutional barriers of uniformity is certainly worth considering. If the taxing measure set up through the classified structure merely separates the different types of

\textsuperscript{52} Ordinance of the Philadelphia City Council, 656. Approved December 13, 1939.

\textsuperscript{53} It is to be noted that the uniformity requirement of the constitution has been held not to apply to special assessments for street improvements, the court reasoning that assessments for purely local benefits are of a peculiar nature and are as a special classification of tax. Beaumont v. Wilkes-Barre, 142 Pa. 198, 21 Atl. 888 (1891).

\textsuperscript{54} PA. CONSTR. art. IX, § 1 (1923).

\textsuperscript{55} 320 Pa. 180, 181 Atl. 598 (1935).

income and attempts to tax each in a different manner, it is merely a round-
about way of imposing a graduated income tax and would be unconstitu-
tional. In the graduated income tax you are taxing different quantities of
of the same whole in a different manner, while by the former method you
are taxing the various factors that make up these amounts in a different
manner. The only defense to such a system would be that this classifica-
tion of the different types of income and their taxation at different rates
is founded on sound and reasonable distinctions. It would be hard indeed,
to justify different rates of tax on the various ways of earning income, as
some of these means are definitely related to one another, and should not
be classified separately. While one might argue that income from labor,
in the form of salary, commissions, or wages ought to be taxed differently
than income from rents or long-term investments, it would be hard to
visualize a sound basis for a differentiation between tax rates on dividends
and rents. Again, the Philadelphia wage tax is directly in point. This
revenue ordinance taxes net profits of business and professional activity,
and gross wages and salary. While the constitutionality of its scope has
been tested many times, the courts as yet have not directly passed on its uni-
formity aspect. In upholding its constitutionality the courts have appar-
ently assumed that this is either (1) a similar tax, as uniform as the cir-
cumstances will allow, on net income (gross take-home pay), or (2) a
proper differentiation of income into separate classes. The first mentioned
assumption has been previously mentioned in this paper. It was found
that an apparently unauthorized collection regulation corrected this diver-
sity of treatment. Absent this regulation, the ordinance itself seems to
offend the uniformity provision of the constitution since it allows the earners
of one type of income to deduct necessary expenses incurred in the accumu-
lation of that income, though denying this right to salaried workers, or
those on commission. The second assumption opens a new field of discus-
sion. If we state that income from salaries, wages, commissions and other
forms of compensation is sufficiently different from income derived through
professional or business activity to justify a different manner of taxation,
there is the further implication that all other means of procuring income
are of a still different nature, and are not to be taxed at all. Thus the
Philadelphia wage tax would appear to violate the uniformity provisions
of the constitution unless the regulations are considered part of the
ordinance.

C. Excise Tax or Property Tax?

The courts of Pennsylvania have considered at length on various
occasions whether a tax levied on net income is in fact an income tax or an
excise tax. The statement in an act that it is an income tax or an excise

57. Commonwealth v. Electrolux Corp., 59 Dauph. 412 (Pa. 1949); Common-
wealth v. Warner Brothers Theaters, Inc., 345 Pa. 270, 27 A.2d 62 (1942); Com-
tax is given little weight by the courts. The question is important for two reasons: (1) it is a subordinate issue to the question of whether or not an excise tax is subject to the uniformity provision of the state constitution, and (2) it is determinative as to the constitutionality of a tax that is claimed to be assessed on improper subject matter. The questions will be considered in that order.

There has been much discussion in the courts as to whether the Corporate Net Income Tax Act is an excise tax or an income tax. While the act states that it is an excise tax, and many decisions have upheld this view, others have asserted that it is an income tax. This latter view apparently is based on the thought that the municipal mercantile taxes must be upheld, this, in turn, rests on a finding that the corporate net income tax be considered an income (property) tax, or the field would be pre-empted by the Commonwealth. On the other hand, a tax on the income of individuals has been held to be an income tax. In other states, however, there is much authority for the point that an income tax is an excise tax. Should the concession be made that a particular tax on income is an excise tax, then the proponents of this view state the second premise of their argument, namely, that the uniformity provisions of the state constitution apply only to taxes on property. This position is defended on the ground that the exemption provisions of the constitution refer solely to property and that, therefore, they apply solely to property. However, the Supreme Court of Pennsylvania has expressly stated that a tax on the income of individuals is in the nature of a tax on property. The court reasoned that a tax on income is a tax on the property, both real and personal, that produces the income, as it reduces the overall value of the property. Furthermore, income derived from property is property, as property produces its own kind; that is, it produces property and not something different. Therefore, whatever the name of the tax may be, the character of the revenue measure is a property tax when the revenue is derived from income of individuals. Thus, in Pennsylvania, a tax on the income of individuals is a property tax, and is subject to the uniformity provisions


65. See note 45 supra.
of the state constitution. Whether the classification of an income tax as an excise tax would put it beyond the application of the uniformity provision is not certain. However, it would appear to make no difference whatsoever, for the terminology of the provision that is sought to be avoided is, "All taxes shall be uniform . . . ." (Emphasis added.), 66 and this phrase has been interpreted by the courts of Pennsylvania in its broadest sense. 67

The other important reason for determining whether a tax is in the nature of an income tax (property tax) or an excise tax lies in the fact that although an item might be an improper subject of property taxation, it could be a proper base for the assessment of an excise tax. To illustrate this statement, let us assume that item A is not the proper subject of a property tax because it violates the uniformity clause. Yet, item A could be the proper base for the application of an excise tax, provided that the mechanism of the revenue measure was uniform in rate and other essentials. The rationale behind this latter statement is that the tax law would be uniform in application were it an excise tax, for the subject matter of the excise tax is the privilege of doing business or carrying on some activity within the state and not the property itself that is made the base of such tax.

II.

Occupancy of the Field.

In many states, municipalities are unable to levy taxes on a particular subject matter due to the fact that the state has already enacted revenue-producing legislation in that field. This doctrine of pre-emption is most evident in the Commonwealth of Pennsylvania since the Sterling Act 68 was passed. Through this legislative enactment, the General Assembly delegated its power to tax in many areas to the municipalities. The act stipulates, that should the Commonwealth enact similar legislation in the future, the municipal ordinance will be rendered ineffective as of that date. 69 Outstanding examples of this pre-emption doctrine have occurred with regard to corporate property, 70 corporate income, 71 the privilege of using tangible property, 72 and the physical plant of a TV company. 73 Apparently in conflict with this doctrine would be the amusement tax which is levied by municipalities, though the state had already enacted tax legislation on the subjects of retail liquor sales and amusement permits. 74 The latter has

66. PA. CONST. art. IX, § 1 (1923).
69. See note 68 supra.
The court, when faced with this problem, disposed of the issue under consideration by stating that the sole issue before the court was whether or not a municipality in the exercise of the police power may require a person to obtain a permit in addition to and not in conflict with statutory regulations, and that the issue as to whether the ordinance of the City of Pittsburgh conflicted with the legislation of the Commonwealth was not raised on appeal in that court.\(^\text{76}\)

Thus, any income tax legislation enacted by the General Assembly that does not contain a saving clause continuing municipal wage taxes in effect at the time, would render these local ordinances void as the field of income taxation on that particular subject matter would automatically be preempted by the Commonwealth.

III.
THE CONSTITUTIONALITY OF THE PROPOSED CLASSIFIED INCOME TAX.\(^\text{77}\)

While it has been concluded earlier in this paper that net income is a proper subject for taxation in the Commonwealth the 1955 classified income tax must be examined to see if it would in fact tax net income. The 1955 bill taxed net earnings or profits in each and every category of income covered by the act.\(^\text{78}\) Hence, it may be said with some assurance that it was a tax on net income (gross income less the necessary expenses incurred in the attainment of that income). Thus, the subject matter was proper and constitutional.

A definite threat to the constitutionality of this tax measure is posed by the optional expense deduction listed in the bill.\(^\text{79}\) This section provides that the taxpayer may, in computing his taxable income from wages, salaries, commissions, and other compensation for services rendered for an employer, elect to take a blanket “necessary expense” deduction in lieu of deducting the aggregate amount of money expended in the realization of such income. The Income Tax Act of 1935, which was held to be unconstitutional due to violations of the uniformity clause,\(^\text{80}\) contained similar language. The provisions of the latter act stipulated that single parties were entitled to a living expense exemption of one thousand dollars, while married persons, or heads of families, were allowed a fifteen hundred dollar exemption in computing their taxable income.\(^\text{81}\) It is recognized that the optional deduction in the 1955 bill refers to a deduction used in the computation of net income, while the exemption clauses of the 1935 act referred to living expenses. The provisions of the 1935 act definitely

\(^{75}\) PA. STAT. ANN. tit. 47, § 9-901 (Supp. 1954).
\(^{76}\) Puntureri v. Pittsburgh, 170 Pa. 159, 84 A.2d 516 (1951).
\(^{77}\) PA. H.R. 878, Sess. of 1955.
\(^{79}\) PA. H.R. 878, art. 2, part 2, § 205h, Sess. of 1955.
\(^{81}\) PA. STAT. ANN. tit. 72, § 3402-308 (1935).
offended the constitutional mandate against exemptions, and the optional deduction clause of the 1955 bill must be considered in the light of the uniformity clause of the constitution. The courts permit the deduction of necessary expenses incurred in the attainment of gross income in order to determine net income since the net income and not the gross income is being subjected to taxation. However, no such rationale can be found for the use of the optional deduction provision. It would appear that this is a “gift” from the state only to wage earners and salaried employees. This would discriminate against those who earn income in other manners, as these other means of obtaining income do not have any such optional deduction clause included in their application. One possible answer to this statement is that the differentiation in taxation is justified by the differences in classification. However, assuming for the sake of argument that there is a distinction sufficient to classify income earned by rents or dividends differently from income earned by wages, does such a distinction lie between the latter type of income and income earned by business activity? This distinction does not appear sufficient to justify a differentiation in taxation treatment. Hence, the deduction clause of the 1955 classified income tax bill is apparently unconstitutional. Another possible reason for this optional deduction existing for the benefit of wage earners alone is that it is an administrative or accounting simplification which is not needed in the other area of income tax application. However, this statement loses its force when one considers that the amount of the optional deduction is one thousand dollars a year, and that this blanket deduction is to cover the costs of uniforms, tools, union dues and licenses which are not supplied by the employer. Furthermore, this deduction is extended to all who earn income through salaries, wages, commissions, bonuses and other compensation for services, and many taxpayers who come within this area never have any expenditures of the type to be simplified by the optional deduction clause.

Proponents of the 1955 bill might argue that it is as it states, an excise tax, and, therefore, not subject to the uniformity provisions of the constitution. An excise tax is considered as having for its subject matter a privilege granted by the state, rather than the actual property or figure upon which it is assessed. Hence, it might be argued that since the 1955 bill is an excise tax, it may be levied on objects that would not be the proper subject of a property tax. However, in reply to these arguments it is to be noted that the Pennsylvania Supreme Court has expressly stated that excise taxes come within the application of the uniformity clause; moreover, while it is true that an excise tax may be levied on a subject matter that would not be proper for a property tax, the uniformity provi-
sion of the constitution applies to the manner of determining the figure on which the excise tax will be assessed. Thus, an excise tax whose assessable figure is determined in a non-uniform manner is unconstitutional. Consequently, the blanket deduction clause found in the 1955 classified income tax bill violates the constitution whether the tax be called a property tax or an excise tax.

Another constitutional issue is raised by the rate provisions of the classified income tax bill. The bill provides for different rates of taxation on different types of income. Income is split in this manner into six classes: (1) long term capital gains, gambling winnings, prizes and awards; (2) dividends; (3) interest, rents and royalties; (4) income derived from business, trade, or professional activity; (5) salaries, bonuses, wages, commissions, and other compensation for services; (6) all other taxable income. Each class of income is taxed at a different rate. This system of income taxation suggests two immediate problems; (1) is this just another way of presenting a graduated income tax, and (2) is this system of classification justified. These issues will be discussed in this order.

A graduated income tax is unconstitutional in Pennsylvania. The graduated income tax is assessed at different rates according to the size (i.e. quantity) of the subject matter held by the taxpayer. The 1955 tax bill professes to be a classified income tax, yet it reaches the same results as a graduated tax. The difference is merely in the mechanics of imposing the assessment. The graduated tax differentiates in the size of one's income, while the 1955 differentiates in the manner in which the income is obtained. In practical effect, it would appear to be a distinction of form rather than substance. While the rates of a graduated tax increase according to the size of one's income, the rates of the 1955 bill increase according to that manner of obtaining income which generally would be said to benefit those in the higher income brackets.

This variation in tax rates can be justified if there is a real and sound basis for such classification. It is difficult to find a sound reason for classifying dividends (and therefore taxing them) differently than rents; or for taxing income from a business differently than income from wages or commissions. Even in the light of the vagueness and inconsistency with which the courts have ruled on the classification problems, which were discussed earlier, it would appear that the classifications presented by the 1955 bill are unconstitutional. This bill not only breaks up income into parts, but it shuffles the parts into apparently mis-jointed and non-jointed categories.

86. PA. H.R. 878, art. 2, part 1, § 201a, Sess. of 1955.
87. PA. H.R. 878, art. 2, part 1, § 201b, Sess. of 1955.
88. PA. H.R. 878, art. 2, part 1, § 201c, Sess. of 1955.
89. PA. H.R. 878, art. 2, part 1, § 201d, Sess. of 1955.
90. PA. H.R. 878, art. 2, part 1, § 201e, Sess. of 1955.
91. PA. H.R. 878, art. 2, part 1, § 201f, Sess. of 1955.
It is extremely doubtful whether even the rationale of the purpose doctrine could save such a system of classification from a finding that the attempted differentiation is unreal and unjust, and therefore, unconstitutional.

One last problem concerning the constitutionality of the 1955 income tax bill remains to be considered. It is the provision in the bill stating that all taxes paid to any political subdivision of the Commonwealth are to be deducted from the gross wages or salaries, and the like, in the determination of the taxable (net) income. This provision affects both the occupancy of the field question, as well as the uniformity issue. In attempting to circumvent the wage tax field, and thus evade possible pre-emption of the area now occupied by municipalities, the 1955 bill allows the amounts paid to political subdivisions to be deducted from gross income in arriving at the figure representing taxable income of wages and salaries; but this deduction at first sight is not allowed in the determination of the net profits figure upon which businesses, trades, and professions are taxed. However, this apparent inconsistency is easily clarified on the basis of the manner of determining taxable income under the federal income tax law. The business or professional income that is taxed by the 1955 bill is the business profit as returned to and ascertained by the federal government. The computation of this figure for federal income tax purposes includes a deduction for taxes paid to political subdivisions of a state. The taxable income from wages and salaries is assessed by the 1955 bill upon adjusted gross income as determined for federal income tax purposes; but adjusted gross income of an individual for federal purposes does not include a deduction for these municipal taxes. Hence, provision is made in the 1955 bill for the deduction of these amounts by individuals. Thus, what at first hand appears to be an irregularity in the bill turns out to be a necessary provision to insure uniformity and proper classification.

IV.

Conclusion.

While it is true that the taxing power is vested absolutely in the legislature, subject to the limitations of state and federal constitutions, the courts of the Commonwealth will interfere when the legislative measures

95. PA. H.R. 878, art. 2, part 2, §205g, Sess. of 1955.
96. See note 95 supra.
create inequalities, or are evasions or violations of the constitution. The courts will not have the opportunity to formally answer the question of the constitutionality of the proposed income tax, since its passage was defeated by the State Senate. On the basis of the reasons set out in this Comment, it is submitted that had the bill been enacted it would have enjoyed a short life once the question of constitutionality reached the courts. The constitution of Pennsylvania is written in such a way as to almost defy modern notions of income taxation to hurdle its legal barriers; for, while net income is recognized as a proper subject of property taxation, the uniformity clause and the prohibition against exemptions other than those set forth in the constitution prevent the popular concepts of general exemptions, personal deductions, optional deduction clauses, and graduated rates of taxation from taking effect in Pennsylvania. Certainly, any income tax that would escape the various tentacle-like provisions of the constitution as it now stands, would not only be an oddity of tax legislation, but would no doubt be lacking in revenue-producing power. The constitution of Pennsylvania, as it now reads, is diametrically opposed to any type of taxation based on ability to pay.

It would appear, further, that the courts of the Commonwealth have been satisfied with the original interpretations of the uniformity provisions, and that there is no noticeable change in the judicial atmosphere which would indicate a change in the interpretation of the relevant clauses. Apparently, the only answer to the problem is to amend the constitution to permit the modern concept of income taxation in Pennsylvania. Such an amendment could either specifically permit a graduated income tax, or would clothe the legislature with an unrestricted general taxing power.

Neale F. Hooley.

(Ed. Note: On September 27, 1955, a bill (House Bill No. 1390) was passed in the House of Representatives and has since been referred to the Senate Committee on Constitutional Changes and Federal Relations. Introduced by Messrs. Readinger and Lovett, this bill not only includes the stipulation that the ninth article of the state constitution should not apply to the taxation of income, but further provides the manner in which funds so derived are to be spent. While four similar bills have been introduced in the legislature in recent years, none have contained the "spending" clause written into House Bill No. 1390).

102. The State Senate defeated the passage of the bill by a vote of 26-23, after the House of Representatives had approved the measure by a vote of 108-98.
103. PA. CONST. art. IX, § 1 (1923).
104. PA. CONST. art. IX, § 2.
An Act
To provide revenue for Commonwealth purposes by imposing an excise tax on certain classes of taxable income as defined of individual residents and non-residents of the Commonwealth and of estates and trusts fixing the rates of tax thereon providing for the reporting of income payment of tax interest and penalties and installments of estimated tax collection of tax at the source assessments collections liens reviews appeals refunds and penalties and conferring powers and imposing duties upon the Department of Revenue public officers fiduciaries employers corporations partnerships associations and individuals

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

ARTICLE I
SHORT TITLE AND DEFINITIONS

Section 1 Short Title This act shall be known and may be cited as the “Classified Income Tax Act.”

ARTICLE II
IMPOSITION OF TAX

Part I Imposition of Tax
Section 201 Tax on residents Every resident of this Commonwealth shall be subject to and shall pay for the privilege of residing in this Commonwealth and receiving or using or holding income an excise tax which tax shall be levied collected and paid annually upon each dollar of taxable income as herein defined received during the taxable year at rates as follows

(a) Six per centum of the amount of taxable income from net long-term capital gain gambling winnings prizes and awards

(b) Five per centum of the amount of taxable income from dividends

(c) Four per centum of the amount of taxable income from interest rents and royalties

(d) Two per centum of the amount of taxable income from a business trade or profession

(e) One per centum of the amount of taxable income from wages salaries bonuses commissions and other compensation for services

(f) One per centum of the amount of all other taxable income

Section 202 Tax on non-residents Every natural person not a resident of this Commonwealth shall be subject to and shall pay for the privilege of carrying on a business trade profession or occupation within this Commonwealth or of owning or leasing property herein an excise tax which tax shall be levied collected and paid annually upon each dollar of his taxable income as herein defined received during the taxable year at rates the same as those specified in section two hundred one

Section 203 Tax on estates and trusts The tax imposed by this part on residents and non-residents similarly shall be levied collected and paid annually upon each dollar of the taxable income as herein defined of estates and trusts received during the taxable year

Part II Definitions
Section 204 Taxable income defined The term “taxable income” means the sum of the amounts derived from the sources of income defined in section two hundred five

Section 205 Sources of income defined (a) Taxable income from net long-term capital gain. The term “taxable income from net long-term capital gain” means the excess of long-term capital gains for the taxable year over the long-term capital losses for such year as returned to and ascertained by the Federal Government.

(b) Taxable income from gambling winnings. The term “taxable income from gambling winnings” means the amount of net profits or gains as returned to and ascertained by the Federal Government resulting from gambling activity during the taxable year.

(c) Taxable income from prizes and awards. The term “taxable income from prizes and awards” means the amount of gross income from prizes and awards as returned to and ascertained by the Federal Government less the ordinary and necessary expenses of earning or collecting prizes and awards.

(d) Taxable income from dividends. The term “taxable income from dividends” means the amount of gross income from dividends as returned to and ascertained by the Federal Government less the ordinary and necessary expenses of producing or collecting said dividends.

(e) Taxable income from interest. The term “taxable income from interest” means the amount of gross income from interest as returned to and ascertained by the Federal Government less the ordinary and necessary expenses of producing or collecting said interest and less interest received on United States securities.

(f) Taxable income from rents and royalties. The term “taxable income from rents and royalties” means the net profits from rents and royalties as returned to and ascertained by the Federal Government.

(g) Taxable income from a business trade or profession. The term “taxable income from a business trade or profession” means the amount of business profit of farm profit and of partnership profit as returned to and ascertained by the Federal Government except that no deduction shall be allowed in any case for net operating losses sustained during any other taxable year nor shall any net operating loss sustained during the taxable year be allowed as a deduction for any prior taxable year and that in computing partnership profit no amounts shall be included which are derived from the sources defined in subsections (a) to (f) inclusive unless said amounts represent profit from a bona fide business activity of the partnership. In no event shall such amounts be included as partnership profit where the partnership form is used to avoid the tax which would otherwise be paid on the amounts derived from these sources.

(h) Taxable income from wages, salaries, bonuses, commissions and other compensation for services. The term “taxable income from wages, salaries, bonuses, commissions and other compensation for services” means the amount of adjusted gross income from wages, salaries, bonuses, commissions and other compensation for services including professional services performed by an employee for his employer including the cash value of all remuneration paid in any medium other than cash as returned to and ascertained by the Federal Government less all taxes imposed by a political subdivision of this Commonwealth and less any other expenses of earning producing or collecting said income not heretofore deducted in arriving at adjusted gross income those deductions to consist of those expenses which have been actually paid by the taxpayer during the taxable year and for which he will not be reimbursed and shall include but not be limited to purchase and maintenance of uniforms and tools required by an employer union dues and assessments and license fees. Such expenses shall not include costs of personal maintenance which bear no direct relation to the earning producing or collecting of the income such as cost of wearing apparel not required as a uniform food and medical expenses. Provided however, that no expense shall be deducted unless actually paid out of taxable income from wages, salaries, bonuses, commissions and other compensation for services as defined in this subsection and provided further, that in lieu of the expense deduction provided in this subsection the taxpayer may elect at his option an alternate expense deduction of one thousand dollars ($1,000).

(i) All other taxable income. The term “all other taxable income” means the amount of adjusted gross income as returned to and ascertained by the Federal Government plus any net operating loss from any other year deducted in computing adjusted gross income and less.

1. any amount of gross income adjusted gross income or net gains or profits attributable to the respective sources specified in subsections (a) to (h) inclusive and

2. the expenses of earning producing or collecting said all other taxable income.
Section 206 Returned to and ascertained by the Federal Government defined The term "returned to and ascertained by the Federal Government" means

(a) submitted to the Federal Government on the applicable form of tax return or schedule thereof for the taxable year or

(b) which would have been submitted to the Federal Government on the applicable form of tax return or schedule thereof if the individual had made a return to the Federal Government for the taxable year subject however to any correction for fraud evasion or error as finally ascertained by the Federal Government

ARTICLE III

COMPUTATION OF TAXABLE INCOME

Part I Estates and Trusts

Section 301 Application of tax The taxable income of estates or of any kind of property held in trust shall include

(a) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests and income accumulated or held for future distribution under the terms of the will or trust

(b) Income which is to be distributed currently by the fiduciary to the beneficiaries and income collected by a guardian of an infant which is to be held or distributed as the court may direct

(c) Income received by estates of deceased persons during the period of administration or settlement of the estate and

(d) Income which in the discretion of the fiduciary may be either distributed to the beneficiaries or accumulated

Section 302 Computation and payment The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual except as otherwise provided in this part The tax shall be computed on such taxable income and shall be paid by the fiduciary

Section 303 Additional deduction (a) In computing the taxable income of an estate or trust there shall be allowed as an additional deduction any amount returned to and ascertained by the Federal Government as income required to be distributed currently or properly paid or credited or required to be distributed during the taxable year to any beneficiary

(b) Character of amounts deducted The amount determined under subsection (a) shall be treated as consisting of the same proportion of each class of items entering into the computation of gross income of the estate or trust as the total of each class bears to the total gross income of the estate or trust in the absence of the allocation of different classes of income under the specific terms of the governing instrument

Section 304 Inclusion of amounts in gross income of beneficiaries (a) Inclusion In computing the gross income of a beneficiary of an estate or trust there shall be included any amount deducted under section three hundred three (a) by the estate or trust

(b) Character of amounts included The amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust as determined under section three hundred three (b)

(c) Taxability of amounts included The amounts received by a beneficiary of an estate or trust shall be subject to taxation according to their character as determined in subsection (b) at the rates set forth in section two hundred one

Section 305 Different taxable years for estate or trust and beneficiary If the taxable year of a beneficiary is different from that of the estate or trust the amount to be included in the gross income of the beneficiary shall be based on the gross income of the estate or trust and the amounts properly paid credited or required to be distributed to the beneficiary during any taxable year or years of the estate or trust ending within or with his taxable year
Part II Partners and Partnerships

Section 320 Partners subject to tax A partnership as such shall not be subject to the tax imposed by this act. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.

Section 321 Taxable income of partner (a) Distributive share The taxable income of a partner shall include his distributive share of the net profits of the partnership whether distributed or not.

(b) Character of distributive share The amount determined to be the partner’s distributive share of partnership profit shall have the same character in the hands of the partner as in the hands of the partnership. Any amounts not included in partnership profit under section two hundred five (g) shall be stated separately and taxed at the rates as set forth in section two hundred one.

Section 322 Different taxable years for partner and partnership If the taxable year of a partner is different from that of the partnership then the taxable income of the partner shall be based on the taxable income of the partnership during any taxable year of the partnership ending within the taxable year of the partner.

Part III Exclusions from gross income

Section 330 General rule There shall be excluded in computing gross income those amounts specifically excluded in the computation of income to be returned to and ascertained by the Federal Government.

Section 331 Additional exclusions In addition to the exclusions provided for in section three hundred thirty there shall be excluded from gross income the following items:

(a) Unemployment compensation Any amount received by any person under the provisions of the Unemployment Compensation law of this Commonwealth.

(b) Public assistance Any amount received by any person as assistance under the provisions of the Public Assistance Law of this Commonwealth.

(c) Social security Any amount received by any person as social security benefits under the Federal Social Security Act.

(d) Railroad retirement or unemployment insurance Any amount received by any person as an annuity or pension under the Federal Railroad Retirement Act or as unemployment benefits under the Federal Railroad Unemployment Insurance Act.

(e) State retirement Any amount received by any person under the provisions of any retirement law or system of this Commonwealth or political subdivision thereof.

Part IV Miscellaneous Provisions

Section 340 Inventories Whenever in the opinion of the department the use of inventories is necessary in order clearly to determine the income of any taxpayer inventories shall be taken by such taxpayer on such basis as the department may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

ARTICLE VI

MISCELLANEOUS PROVISIONS

Section 601 Saving clause Notwithstanding anything contained in any law to the contrary the validity of any ordinance or part of any ordinance or any resolution or part of any resolution and any amendments or supplements thereto now or hereafter enacted or adopted by any political subdivision providing for or relating to the imposition levy or collection of any tax on wages salaries bonuses commissions or other compensation for services or on net profits of a business trade profession or occupation shall not be affected or impaired by anything contained in this act.

Section 602 Constitutional construction If any section sentence clause or part of this act is for any reason held to be unconstitutional the decision of the court shall not affect or impair any of the remaining provisions of this act. It is hereby declared as the legislative intent that this act would have been adopted had such unconstitutional sentence section clause or part thereof not been included herein.
Section 603 Effective date The provisions of this act shall take effect as follows

(a) The first day of January one thousand nine hundred fifty-five except as specified in subsections (b) and (c)

(b) The first day of July one thousand nine hundred fifty-five for the purposes of the tax imposed by section two hundred one (c) and the provisions of Article IV relating to the collection of income tax at the source and any other provisions relating to the computation and administration of said tax and the collection thereof

(c) The first day of July one thousand nine hundred fifty-five for the purpose of making and filing the declaration of estimated tax required by section five hundred twenty-four Payment of said tax shall be made in accordance with the provisions of section five hundred forty-one