Non-Property Taxes in a Fair and Equitable Tax System

REPORT 5

THE GREAT SEAL OF THE STATE OF NEW JERSEY

LIBERTY AND PROSPERITY

1776

NEW JERSEY TAX POLICY COMMITTEE

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Part V

of the Report of the

NEW JERSEY TAX POLICY COMMITTEE

Non-Property Taxes in a Fair and Equitable Tax System

Submitted to Governor William T. Cahill
pursuant to Executive Order No. 5 of 1970

The report consists of
five separate parts and
a summary volume

TRENTON, NEW JERSEY
February 23, 1972

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(appointed by the Governor pursuant to Executive Order No. 5 of 1970)

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Report Part V

Non-Property Taxes in a Fair and Equitable Tax System

Synopsis of Part V

This part of the Report covers the gamut of taxation beyond the property tax in New Jersey. It deals with three prime criteria of a well balanced state and local tax system, adequacy, progressivity and elasticity.

The recommendations of the Report will enable the state to accomplish the massive shift in tax burden from local real estate to non-property taxes—which is the core theme of the entire Report. As a guide to the selection of alternatives, the Committee compared the impact of the New Jersey tax system on business and individuals with the systems in other states. The comparisons produced different results for individuals and for industry:

> Of special significance, while New Jersey ranks 33rd among the states in its gross state-local tax burden per $1,000 of total income received in this state (Part I of the Report), the actual tax burden on a family of four is highest in New Jersey, among all the sample states, for the two lowest income levels, and does not come down to the all-state average until the $25,000-and-up income levels. This is due primarily to the heavy use of property taxation in New Jersey, which is reflected as a higher than average burden on lower income groups due to the operation of the property tax on shelter costs of the family.
>
> It was also found that the burden of state and local taxes in New Jersey upon manufacturing business is now comparatively high or low depending upon the property tax location of the plant.
>
> If the corporate profit is high in the particular business entity, in some industries a relatively high property tax component may be offset by New Jersey's relatively lower corporate income tax, in the comparisons.
>
> Major property tax relief proposed by the Committee should reduce the inter-municipal disadvantage of Newark and similar high tax areas, but an increased corporate income tax is likely to offset this advantage for profitable companies in inter-state comparisons.

Restructuring the System

Under an "average financing system" approach (that is, comparing the tax raising capacity of New Jersey to the average tax system among the states), New Jersey's taxes as a percent of relative capacity are reported as follows:

Business taxes—85%
Local non-farm residential property taxes—176%
Other personal taxes—68%
Total personal taxes—102%

Using the income elasticity and progessivity approaches, it is plain that the New Jersey tax structure very much needs a shift from property taxation to income taxation.

The Committee recommends:

As a present goal, at least until the effects the proposed restructuring of the tax system, together

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with possible Federal takeover of welfare or revenue sharing, are achieved and stabilized, that the state shift to a state-local revenue system using one-third property taxes, one-third income taxes and one-third sales taxes.

The Committee further recommends:

Replacement revenues for the property tax shall be sought from income elastic sources with progressive rate structures, sufficient to overcome the deficiencies of the present tax structure; and

Specific tax sources should be selected, following these principles, and with due regard to comparative tax burdens, from both business and personal levies.

Taxation of Business

This section of the Report consists of a detailed professional analysis of the policy and technical aspects of all of the major taxes of the State which have their initial impact on business. Many proposals for change are examined and rejected. Others have resulted in positive recommendations.

(1) The corporation net income tax rate should be increased from the current 4¼% of taxable income to 7¼% beginning in 1972, and no higher.

(2) The net worth tax rate should remain unchanged from the current rates of 2 mills per dollar on the first $100 million of taxable net worth, and decreasing by steps to the lowest rate of 2/10 of a mill per dollar on taxable net worth in excess of $300 million.

The Committee recommends:

The policy now reflected in the corporation business tax of treating all items of income within the apportionment formula should be continued, and that proposals for specific allocation of items such as dividends, interest, capital gains, rentals, service income, and the like, should be rejected.

Leased real estate and tangible personal property should be included in the numerator and denominator of the property factor of the apportionment formula of the corporation business tax, and such property should be valued at eight times the gross rental.

The receipts factor of the apportionment formula should be modified by adopting the throw-back rule (to the state of origin) with respect to goods shipped to customers located in any other state, the District of Columbia or Puerto Rico, in circumstances in which the buyer's state does not have the power to impose an income or franchise tax on the vendor.

For purposes of the receipts factor also under the apportionment formula, sales of goods to the United States government shoud be allocated to the state of origin of the shipment.

Other Taxes on Business

The Committee recommends:

Repeal of the present state gross receipts tax on unincorporated business;

Repeal of the retailers gross receipts tax;

Increase in the tax rate on the present business personal property tax from $1.30 per hundred to $2.00 per hundred on the basis of 50% of the original acquisition cost of machinery and equipment to the taxpayer.

Banks and Insurance Companies

This part carefully reviews the existing system of taxation of banks and insurance companies in New Jersey. Bank taxation is complicated because of the close interrelationship between a state's laws taxing national banks and Federal enabling legislation; and state insurance taxes are complicated by a historic development of retaliatory tax provisions among the various states.

The Committee recommends:

Revision of the taxation of banks and other lending institutions must await enabling legislation by Congress;

Meanwhile, a tax measured by net income at the rate of 5% should be enacted to apply to all financial businesses which are not subject to the bank stock tax, financial business tax or corporate business tax act.

The recommendations with respect to the taxation of insurance companies call for further study of a number of technical problems; propose elimination of the present limitation that no more than 12½% of a company's total premiums may be deemed to be on risks in this state; and proposes that the present system of discriminatory and retaliatory insurance taxes among the states should be abolished, and to this end New Jersey's representatives in the Congress are urged to sponsor appropriate Federal legislation.

The Committee recommends no change in the present system of taxation of public utilities and railroads.

Value Added Tax

The Committee has seriously explored the possibilities of a value added tax for New Jersey. The structure of such a tax is described in Chapter IX. Based upon experience elsewhere, and the implications for an industrial State such as New Jersey, the Committee concludes that a value added tax should not be considered as a potential source of revenue for the State, or as a possible component of a balanced tax structure, for the following reasons in particular:

1. The value added tax is merely a series of sales taxes, which would ultimately be paid by the consumer, and would duplicate the sales tax already on the books;

2. It is not practicable for a single industrial State to consider a value added tax for the reason that out of state purchases and sales at the various stages of production would greatly undercut the assumption that the tax will be passed on to the ultimate consumer; and this may place various producers at a competitive disadvantage; and

3. It is apparent that the field of value added taxation may well be pre-empted by the Federal government, in light of recent announcements.

Taxation of Individuals

This section of the Report deals with death taxes, sales taxes and income taxes. Each of these taxes involve broad policy questions and also many technical aspects which bear upon policy. For the latter, it is essential to refer to the full text of this part. In brief,

The Committee recommends:

***As to death taxes*—retain the present structure of the Transfer Inheritance Tax (rather than change to a Federal estate type tax) and;**

1. Increase to $20,000 the present exemption of $5,000 which has been in effect since 1914 on transfers to spouse, issue, parents, etc. (Class A beneficiaries);

2. Impose a flat 5% tax rate on transfer in excess of $5,000 to non-educational charities;

3. Eliminate the present exemption on non-homestead property held as joint tenancies by the entirety;

4. Establish a more equitable tax on qualified pension and profit-sharing plans by taxing those assets only to the extent of the percentage of the decedents' contributions to fund such benefits. This conforms with the treatment of these assets for Federal Estate Tax purposes; and

5. Tax life insurance proceeds to named beneficiaries, including inter-vivos trustees, to the extent that such proceeds exceed:

a. $50,000 paid directly to the decedents' surviving spouse; plus

b. An additional $10,000 for payments in excess of $50,000 to the decendents' surviving spouse for each surviving minor child of the decedent who lives with the surviving spouse; plus

c. $10,000 for each Class A beneficiary other than the decedents' surviving spouse.

The Sales Tax

The New Jersey Sales and Use Tax has been found to be almost proportional—certainly it is not regressive according to the progressivity indices prepared for the Committee. The Report finds two major deficiencies in the tax as it is now structured:

1. The sales tax is full of excessive and inconsistent exemptions—perhaps more than any other state; and

2. The sales and use tax, originally designed as a tax on consumption by the ultimate consumer, results in major inequities in failing to tax spending where services rather than goods are purchased. On the other hand, the taxation of sales of machinery and equipment used by industry in production of goods in New Jersey is counter productive in the long run, because of its adverse competitive effect on interstate business.

Accordingly, the Committee recommends a series of changes of the sales and use tax which, together with their revenue effects, are as follows:

ESTIMATED REVENUE IMPACT OF PROPOSED SALES AND USE TAX ACT REVISIONS

Extend Sales Tax to:	$(Millions)
On-Premises Consumption of Alcoholic Beverages	6.0
Clothing and Footwear—less low income rebate ($10 million)	70.0
All Services, except Health, Barber & Beautician	154.0
Magazines and Periodicals	0.6
Casual Sale of Aircraft and Boats	0.8
Certain Coin Machine Sales	1.0
Films, Records, Tapes in Theater, Radio and Television Production	1.2
Sales Covered by Local Sales Tax	4.0
Building Materials (8w) (now taxable, but not taxed)	25.0
Subtotal	262.6
Restore Exemption to:	
Machinery and Equipment	−25.0
Total Estimated Revenue	237.6

An economic analysis of the above changes, which appears in the Report, demonstrates that the extension of the tax to services and the repeal of the exemption on sales of clothing and footwear, will improve the progressivity index of the sales and use tax.

A Proposed Personal Income Tax

The Committee recommends a personal income tax at approximately one-half New York rates for the great majority of taxpayers. This recommendation is central to the tax program required to provide massive relief to real estate. It also provides the missing qualities of progressivity and income elasticity which are essential to convert New Jersey's tax system into a balanced tax structure.

The Committee recommends an income tax which is based essentially on the adjusted gross income of the taxpayer as determined for Federal income tax purposes, with only a few adjustments.

As distinguished from the Federal allowance of $750.00 as a personal exemption to the taxpayer and each of his dependents, deductible from his adjusted gross income, the proposed income tax would provide a tax credit (to be deducted from the tax otherwise calculated), in the amount of $15.00 for the taxpayer and each dependent. This is equivalent to the personal exemption of $750.00 at the 20% tax bracket.

The rate schedule appears on page 89 of this Part.

Renters are recognized, perhaps for the first time, in the structure of the permissible deductions over the proposal. In the Federal income tax, and in other state income taxes, a taxpayer who itemizes his deductions may deduct his local property tax payments if he is a property owner but he has no way of deducting the property tax that he pays indirectly when he is a renter. The proposal here will permit him to treat 20% of his annual rent as the equivalent of a property tax payment.

Commuters are also specially considered. The thousands of New Jersey residents who commute to work across the state lines, especially to New York, Pennsylvania, Delaware, would be liable for double taxation on their income if the proposal did not make special provision for that situation.

The Committee recommends:

Each resident of the state should report his entire income from all sources, calculate the tax at New Jersey rates, and then be allowed a credit for income tax paid in any other state where he has a source of income. The credit could not exceed, however, that proportion of the New Jersey tax which the out-of-state income of the taxpayer bears to his total income.

The Committee further recommends:

That the personal income tax be adopted as the principal means of shifting some of the burden of the property tax to the non-property tax base, and that the shift be recognized as the way to restore balance and equity to the tax system of New Jersey.

It is estimated that the recommended income tax would yield $550 million in 1972.

Miscellaneous Excise Taxes

The Report reviews the structure, equity and yield of each of the major excise taxes.

The Committee recommends:

No change in the basic structure of liquor, cigarettes, gasoline, motor vehicle, and pari-mutuel racing taxes. Rate increases, however, are recommended to bring the New Jersey levies more in line with neighboring states, as follows:

Beer tax—increase from $.03-1/3 per gallon to $.10 (the national average is over $.15)

Still Wines, Vermouth and Sparkling Wines—increase from $.10, $.15 and $.40 per gallon to $.20, $.30 and $.50, respectively

Cigarettes—increase from $.14 per pack to $.18 per pack

Gaming and Other Non-Tax Revenues

The Commission has considered various proposals that the state seek to solve its financial problems by recourse to additional gaming revenues. The present levies on parimutuel betting and the profits from the operation of the State lottery now provide substantial revenues, but the Committee does not project any meaningful increases from these sources.

From a strictly revenue standpoint, and without reference to the important moral issues involved in further extension of a state interest in gambling activity, the Committee has considered the revenue potentials of off-track betting and casino gambling.

The Committee concludes:

It is clear that additional gaming revenues even with the most optimistic projections of revenues from all forms of gaming which have been put forth, cannot and will not solve the state's revenue problems, nor could they make a significant contribution to the program of massive relief of the local property tax.

Revenue Summary

The combined effect of the various revenue recommendations in this part may be summarized as follows:

ESTIMATED NET ADDITIONAL REVENUE EFFECTS OF PROPOSED TAX LAW CHANGES

	$ (Millions)
ABC	
Liquor	0
Wine	1.0
Beer	9.6
Cigarettes	30.0
Financial Business Tax, Other Than Commercial Banks	2.0
Sales Tax	237.6
Personal Income Tax	550.0
Corporation Business Tax	90.0
Business Personal Property Tax	27.5
Retail Gross Receipts Tax & Unincorporated Business Tax	—21.6
Transfer & Inheritance Tax	0
Total Estimated Net Additional Revenue	926.1

Section A
A Balanced Tax Structure

Chapter I
The Fiscal Context

The preceding four parts of the Committee's Report present these needs and goals of tax reform:

1. To close the revenue gap by providing increased "income elasticity" of the state-local revenue system (Part I), so that the revenue system will have built-in capacity to grow at approximately the same annual rate as expenditures

2. A massive shift in tax burden from property taxation to other sources of revenue (Part II), to be achieved largely through the recommendations of Part III of the Report—and special additional property tax relief for senior citizens

3. Provision for full state funding of the standard public schools educational program (Part III)

4. Provision for a block grant system of state aid to municipalities; and transfer of all welfare, judiciary (excepts municipal courts) and county tax board costs now supported by county property taxes, to be financed by the State out of non-property tax revenues (Part III);

5. Elimination of various inequities.

Implementation of this program, will require about $850,000,000 in non-property revenues, from sources which will increase the income elasticity and progressivity of the State-local revenue structure, will maintain N.J.'s favorable competitive conditions for economic development, and will achieve a balanced tax structure with flexibility to meet present and future revenue needs.

The redistribution of tax burden implied in these goals underscores the importance of re-examining the adequacy, equity, stability and feasibility of the entire revenue system.

Characteristics of the Present System

In 1971, the combined total of state and local taxes in New Jersey amounted to $3.8 billion. See Table 5-1. The sources of state tax collections included in this table are shown in Table 5-2. In addition, the state annually apportions for local collection the public utilities gross receipts tax ($88.5 million in 1971), the public utilities franchise tax ($64.3 million in 1971) and insurance tax revenue of $6 million, a total of $153.4 million in 1971.

State government is supported entirely by non-property taxes, whereas county, municipal and school governments are supported by property taxes, the various taxes collected by the state for distribution to local governments or apportioned by the state for local collection, together with miscellaneous state aids and local non-tax revenues.

In brief, the problem of the tax policy before the State is this: how to redistribute the total state-local tax burden so as to satisfy the goals of tax reform at present under a tax structure which will generate revenues in the future adequate to meet the needs as they develop.

This problem of tax policy should be approached as a problem in redesign of the state-local revenue structure on the basis of principle. Unfortunately the principles of taxation and public finance do not lend themselves to a simple application which produces a direct solution. The principles do provide firm guidance, however, within which some options may be selected. For convenience of analysis these options may be considered under two broad headings:

A. The comparative tax burden approach and

B. The balanced tax structure approach.

TABLE 5-1

THE NEW JERSEY STATE AND LOCAL TAX STRUCTURE

(in millions of dollars)

TAX YEAR	Taxes Collected by the Division of Taxation	Taxes Collected by the State Outside of the Division	Taxes Apportioned by State for Local Collection	Taxes Administered by Counties	Taxes Administered by Municipalities*	Total State and Local Taxes
1955	$ 167.9	$ 80.1	$ 47.7	$ 2.5	$ 520.0	$ 818.2
1956	185.2	76.8	51.8	2.7	565.9	882.4
1957	204.9	86.3	57.1	2.9	631.5	981.8
1958	206.8	87.2	66.1	3.0	696.4	1,059.5
1959	254.1	91.1	70.0	3.2	758.6	1,177.0
1960	277.6	95.5	75.5	3.5	819.6	1,271.7
1961	292.7	99.6	80.7	3.7	886.2	1,362.9
1962	336.3	102.6	90.0	4.1	956.7	1,489.7
1963	367.2	110.1	95.4	4.4	1,021.3	1,598.4
1964	407.8	118.9	99.4	4.6	1,142.7	1,773.4
1965	426.6	120.2	105.5	5.1	1,220.6	1,878.0
1966	466.2	125.3	111.7	5.5	1,262.8	1,971.5
1967	706.7	127.1	119.5	5.9	1,444.7	2,403.9
1968	818.0	134.8	127.2	6.4	1,553.0[1]	2,639.4
1969	1,013.1	159.9	135.9	10.4	1,677.7[1]	2,993.6
1970	1,153.0[2]	168.6	146.2	19.5	1,933.8[1]	3,417.3
1971	1,310.0[2]	173.2[3]	159.0	21.3	2,188.3[1]	3,851.8

[1] Effective in 1968, business tangible personal property other than telephone and telegraph, was eliminated from the local tax base in favor of replacement taxes collected by the State for distribution to the local taxing districts.

[2] Does not include Bank Stock Taxes paid to the State by counties (1970-$3,684,772; 1971-$7,843,129).

[3] Does not include $33,362,066 collected by the Lottery Commission.

*Exclusive of Atlantic City Luxury Sales Tax Collections:

1955	$1,546,985.32	1963	$1,842,467.39
1956	1,584,672.50	1964	1,853,252.09
1957	1,645,039.56	1965	2,005,564.46
1958	1,555,976.25	1966	2,100,804.16
1959	1,808,101.18	1967	2,066,634.24
1960	1,778,585.22	1968	2,973,159.04
1961	1,742,352.35	1969	3,319,758.18
1962	1,810,259.61	1970	3,714,149.87
		1/1-6/30-1971	1,273,569.94

TABLE 5-2

State of New Jersey

MAJOR STATE TAX COLLECTIONS (NET) 1969-1971

Collected by Division of Taxation	1971	% of Total	1970	% of Total	1969	% of Total	Percent Change 1971-1970	Percent Change 1970-1969
Alcoholic Beverage Tax	$ 43,513,113	2.9%	$ 42,474,480	3.2%	$ 36,033,318	3.1%	+ 2.4%	+ 17.9%
Bank Stock Tax	7,843,129	0.5	3,684,773	0.3	—	—	+112.9	—
Business Personal Property Tax	50,978,295	3.4	45,842,490	3.5	41,950,322	3.6	+ 11.2	+ 9.3
Cigarette Tax	123,804,999	8.3	117,921,850	8.9	116,940,470	10.0	+ 5.0	+ 0.8
Corporation Business Tax	169,667,694 (1)	11.4	221,812,921	16.7	207,223,401	17.7	− 23.5	+ 7.0
Emergency Transportation Tax	18,498,782	1.2	17,030,300	1.3	14,601,810	1.2	+ 8.6	+ 16.6
Financial Business Tax	3,581,862	0.2	4,250,048	0.3	1,724,380	0.1	− 84.3	+146.5
Insurance Premiums Tax	43,283,820	2.9	34,690,167	2.6	33,545,404	2.9	+ 24.8	+ 3.4
Motor Fuels Tax	210,255,462	14.1	199,599,110	15.1	187,392,295	16.0	+ 5.3	+ 6.5
Outdoor Advertising Tax	236,664	<0.1	126,171	<0.1	130,298	<0.1	+ 87.6	− 3.2
Public Utility Excise Tax	30,670,472 (2)	2.1	18,822,217	1.4	17,445,908	1.5	+ 62.9	+ 7.9
Railroad Franchise Tax	52,790	<0.1	97,948	<0.1	151,665	<0.1	− 46.1	− 35.4
Railroad Property Tax	7,312,073 (3)	0.49	7,434,522	0.6	7,981,270	0.7	− 1.6	− 6.9
Retail Gross Receipts Tax	4,574,104	0.3	3,948,827	0.3	3,837,995	0.3	+ 15.8	+ 2.9
Sales and Use Tax	521,689,350 (4)	34.9	355,613,486	26.8	264,902,239	22.6	+ 46.7	+ 34.2
Transfer Inheritance Tax	63,490,326	4.3	64,236,363	4.8	62,610,564	5.3	− 1.2	+ 2.6
Estate Tax	1,550,239	0.1	2,414,618	0.2	565,688	<0.1	− 35.8	+326.8
Unincorporated Business Tax	17,098,182	1.1	16,695,230	1.3	16,074,007	1.4	+ 2.4	+ 3.9
Total Collected by the Division of Taxation	$1,317,924,099	88.4%	$1,156,695,521	87.3%	$1,013,111,034	86.4%	+ 13.9%	+ 14.2%
Collected Outside Division of Taxation								
Boxing—Wrestling Taxes	30,109	<0.1%	22,927	<0.1%	17,900	<0.1%	+ 31.3%	+ 28.1%
Motor Carriers Road Tax	3,552,064	0.2	3,157,312	0.2	2,269,805	0.2	+ 12.5	+ 39.1
Motor Vehicle Fees	134,880,120	9.0	130,232,394	9.8	122,229,476	10.4	+ 3.6	+ 6.5
Pari-Mutuel Taxes	34,717,612	2.3	35,239,189	2.7	35,456,581	3.0	− 1.5	− 0.6
Total Collected Outside Division	$ 173,179,905	11.6%	$ 168,651,822	12.7%	$ 159,973,762	13.6%	+ 2.7%	+ 5.4%
Total Major State Tax Collections	$1,491,104,004	100.0%	$1,325,347,343	100.0%	$1,173,084,796	100.0%	+ 12.5%	+ 13.0%

(1) Revenue decrease anticipated in view of accelerated tax collection.

(2) Increase due to accelerated tax provision (c. 108 & 109, P.L. 1971).

(3) Represents the assessment levied against railroads but only $2,585,994 was collected because of Penn Central tax default.

(4) Reflects 5% tax for full year.

NOTE: Difference in totals due to rounding. Above revenue figures are reported on a cash collection basis, except for sales tax and financial business tax. Totals may vary somewhat from revenue figures reporting actual collections.

Chapter II

The Taxpayers' Comparative Tax Burden

It has been said that a State should not be a stranger among states, with its tax system. Literally applied, this view would prevent any innovation in tax policy. It is not meant to convey any such limit—only to emphasize that the states of the United States interact: they are competitive and compared; they offer alternative sites for economic development and places to live and work; they are near each other and influence their own progress as well as that of their neighbors by their tax policies. A comparison of state tax structures and their impact is thus one important base from which to measure the benefits of contemplated tax changes.

In Part I of the Committee's Report the present state-local tax structure in New Jersey was compared with other states in simple terms of the gross tax totals per capita and per $1,000 of income payments in each state. This measure does not deal with the structure of the tax system or the impact (who pays at first) or the incidence (who ultimately pays after taxes are shifted into prices, profits, payrolls) of any taxes. To relate total tax collections to population or total income received in a state tells us more about the productivity of the system than about the burden on any individual or business.

Part I of the Report also presents an economic analysis of the *ultimate* distribution of the tax burden in New Jersey. It is based upon certain understandings that business taxes are shifted to consumers or to investors, perhaps even to labor in the form of reduced payrolls. The economic analysis of progressivity of the system and of effective tax rates at different income levels of individuals is thus a significant description of how the tax burden is ultimately distributed—its *incidence,* and is essential to a basic understanding of what we are doing with the tax system.

In this Part of the Report we are concerned with the *impact* of the tax system. That is, we compare the direct tax payments of individuals and of business.

Comparative burden on individuals

A common way to test a State-local revenue system is to compare the burden it imposes upon individuals at various income levels with the burden imposed by other States. Similarly, this may be done for taxes on business, and is probably more pertinent to business tax policy since business has more options as to the State in which it will locate than individuals may have. These comparisons may be quite simple or rather sophisticated, but there have been few satisfactory efforts to compare the tax payments by individuals among the States. Two recent studies have been quite successful in this respect.

In one study, the Washington, D.C. Department of Finance and Revenue compared taxation in the twenty-five largest cities in the United States (not including any cities in New Jersey. Its results were as follows:

Twenty-five City Average Payments

Family: husband, non-working wife, and two school age children—*living in good housing worth 2½ times the family income up to $20,000 and twice the family income above $20,000*

Income Level	% of Income Tax	% Real Estate Tax	% Sales Taxes	% Total Taxes To Income
$ 5,000.	0.6%	5.9%	2.0%	8.5%
$10,000.	1.4%	5.9%	1.5%	8.8%
$15,000.	1.8%	5.9%	1.3%	9.0%
$25,000.	2.4%	4.7%	1.0%	8.1%

A comprehensive study of the combined burden of state and local taxes among all of the states was made at the University of Kentucky in 1969, based upon 1968 data. The study used, for illustration, a family of four in seven different income brackets. It found that, as shown in Table 5-3, the average burden of state and local taxes on a family of four in New Jersey (as compared with the 25-city average above) was 13.4% of income at the $5,000 level, 9.6% of income at the $10,000 level, 6.7% of income at the $17,500 level and 6.5% of income at the $25,000 level. This pattern was similar to the Pennsylvania distribution, although New Jersey was slightly more regressive in the lower income groups.

The same study at the University of Kentucky compares the tax burdens in each state with the average tax burden for all states. As shown in Table 5-4, the average per capita tax burden was $338 for all states, and New Jersey was slightly above the average at 103%. The tax burden per $1,000 of income payments was $108 for all states and New Jersey was below aver-

TABLE 5-3

STATE-LOCAL TAXES PAID BY FAMILY OF FOUR
(Seven Income Sizes, Each State)
as a Percentage of Total Family Income

State	Family Income, Family of Four, 1968						
	$3,500	$5,000	$7,500	$10,000	$17,500	$25,000	$50,000
Average for All States	12.8%	10.9%	9.4%	8.7%	6.5%	6.5%	5.4%
California	12.1	9.8	8.3	7.9	6.3	6.9	6.6
Connecticut	14.6	11.7	9.5	8.2	5.9	5.6	4.4
Illinois	14.6	11.7	9.5	8.2	5.6	5.1	3.9
Indiana	15.4	13.1	11.2	10.1	7.5	7.3	5.7
Maryland	14.6	13.0	12.5	12.6	9.4	9.7	7.8
Massachusetts	14.3	12.1	11.2	10.3	7.6	7.5	5.5
Michigan	12.9	11.1	9.5	8.9	6.9	6.8	5.2
NEW JERSEY	16.3	13.4	10.9	9.6	6.7	6.5	5.2
New York	13.2	11.5	10.5	10.2	8.3	9.7	9.8
Ohio	10.9	9.1	7.6	6.8	4.8	4.7	3.9
Pennsylvania	15.4	13.0	11.1	9.9	7.0	6.7	5.2
Vermont	12.7	11.1	9.9	9.4	7.1	7.3	6.6

Source: Soule, Don M. and Lile, Stephen E., *Some Problems of Equity and Adequacy in Kentucky's State-Local Taxation*, a publication of the Center for the Study of State and Local Government Economics, University of Kentucky, February, 1970.

TABLE 5-4

A COMPARISON OF TAX BURDENS IN PARTICULAR STATES WITH THE AVERAGE TAX BURDEN FOR ALL STATES
Using Alternative Methods for Estimating Tax Burdens

State	Average State-Local Tax Burdens		Family Tax Burdens for Families of Four with Different Income Sizes						
	Taxes Per Capita	Taxes Per $1,000 Income	Size of Income, Family of Four (calendar year 1968)						
	(fiscal year 1968)		$3,500	$5,000	$7,500	$10,000	$17,500	$25,000	$50,000
All-State Average in Dollars	$338	$108	$450	$543	$704	$865	$1,131	$1,636	$2,718
Percents of All State Averages Above (Considered 100 percent)									
California	144	122	94	90	89	91	98	106	121
Connecticut	105	85	113	108	102	95	92	87	81
Illinois	98	84	113	108	101	94	86	79	71
Indiana	90	90	120	120	119	116	115	111	105
Maryland	106	97	114	119	133	145	146	149	143
Massachusetts	117	105	111	111	120	118	117	115	101
Michigan	109	101	100	102	101	104	106	104	96
NEW JERSEY	103	90	127	123	117	110	103	100	96
New York	149	123	102	106	113	118	128	149	179
Ohio	82	80	84	83	81	79	75	72	71
Pennsylvania	88	88	120	119	118	115	108	103	97
Vermont	103	116	98	101	106	109	110	113	121

Source: Soule, Don M. and Lile, Stephen E., *Some Problems of Equity and Adequacy in Kentucky's State-Local Taxation*, a publication of the Center for the Study of State and Local Government Economics, University of Kentucky, February, 1970.

TABLE 5-5

RANKING OF STATES BY TOTAL STATE AND LOCAL TAXES PAID ACCORDING TO INDUSTRY GROUP 1961 & 1965

(by Pennsylvania Economy League)

State	Primary Metals		Food & Kindred Products		Apparel and Other Finished Products		Chemical And Allied Products		Fabricated Metal Products		Electrical Machinery, Equip. & Supplies		Instruments and Related Products	
	1961	1965	1961	1965	1961	1965	1961	1965	1961	1965	1961	1965	1961	1965
PENNSYLVANIA	10	10	10	10	9	9	9	8	9	9	10	9	9	6
Delaware	11	11	11	11	11	11	11	11	11	11	11	11	11	11
Illinois	4	5	6	5	6	5	5	6	4	5	6	6	5	8
Indiana	8	3	5	1	3	1	10	3	6	2	7	2	7	4
Maryland	3	2	4	4	5	4	1	1	3	3	3	3	2	1
Massachusetts	5	6	7	6	8	7	4	4	7	6	5	5	4	2
Michigan	1	1	1	2	1	2	2	2	1	1	1	1	1	3
New Jersey	2	7	2	7	4	8	3	7	2	7	2	7	3	9
New York	9	9	9	9	10	10	8	10	10	10	9	10	10	7
Ohio	7	8	8	8	7	6	7	9	8	8	8	8	8	10
West Virginia	6	4	3	3	2	3	6	5	5	4	4	4	6	5

Note: States are ranked from high to low in terms of tax dollars paid.

Source: Pennsylvania Economy League, Inc., *Taxes Paid by Industry*, December, 1967; the 1961 data are from *Taxes Paid By Industry*, PEL, 1962.

age at 90%. When these tax burdens are analyzed according to the size of the income of various families, the New Jersey burden is 123% of the all-state average in the $5,000 per year income group, equal to the all-state average in the $25,000 per year income group and 96% of the all-state average in the $50,000 per year income group.

In effect, these data show:

While the New Jersey tax system is demonstratively regressive in the lower income groups, its operation is close to the national average in the income groups of $17,500 and above, in 1968.

—The average state tax system is quite regressive; but

—Such states as California, Maryland, New York and Vermont, rise well above the average and have achieved substantially proportional tax systems, except for the lowest income groups, but the latter are the greatest beneficiaries of extremely progressive patterns of government expenditures.

—Of special significance, while New Jersey ranks 33rd among the States in its gross State-local tax burden per $1,000 of total income received in this State (Part I of the Report) or 90 percent of the average (Table 5-4), the actual tax burden on the family of four is highest in New Jersey among all the sample states, for the two lowest income levels, and does not come down to the all-state average until the $25,000-and-up income levels of Table 5-4. This is due primarily to the heavy use of property taxation in New Jersey, which is reflected as a higher than average burden on lower income groups due to the operation of the property tax on shelter costs of the family.

Comparative Tax Burden On Industry

A few years ago, the Pennsylvania Economy League prepared what has come to be a widely cited study of comparative tax burdens on industry. The study was initially published in December 1967 and updated in

March 1969. Table 5-5, taken from that study, shows the varying impact of taxes paid by industry, among different industries, and in different years. Subsequently, the same authorities updated the table to show the effect of the then pending increase in the Pennsylvania corporate income tax rate to 9½% (it was subsequently increased to 12% but becomes 11% on July 1, 1972). Table 5-6 shows that in one industry, apparel and other finished products, the change was so small as not to be reflected in the ranking, when state and local taxes combined are compared. In chemicals and allied products, however, Pennsylvania moved up in the comparison from ninth to sixth.

In March of 1969, the Citizens Research Council of Michigan, another top-flight taxpayer-supported research agency, retained Ernst & Ernst to prepare a report on the comparative corporate burdens of state and local taxes in eight eastern and midwestern cities. They used five hypothetical manufacturing corporations of varying characteristics and located them in each of eight different communities. The corporate balance sheets, statements of operation, costs of goods sold were analyzed, and the size of the corporation was limited to annual sales of between $1.5 million and $5 million and employees of less than 250. A summary of the Ernst & Ernst report, shown in Table 5-7, indicates that Newark would have been the highest cost location tax-wise for one of the corporations but that Milwaukee and Detroit would have been first and second for all of the others; and that Newark would rank fifth among the eight locations for one of the corporations.

It may be concluded that the burden of state and local taxes in New Jersey upon manufacturing business is now comparatively high or low depending upon the property tax where the plant is located.

If the corporate profit is high in the particular business entity, in some industries a relatively high property tax component may be offset by New Jersey's relatively lower corporate income tax, in the comparisons.

Major property tax relief proposed by the Committee should reduce the inter-municipal disadvantage of Newark and similar high tax areas, but an increased corporate income tax is likely to offset this advantage for profitable companies in inter-state comparisons.

TABLE 5-6

PENNSYLVANIA'S RANK AMONG ELEVEN SELECTED STATES[a] IN STATE AND LOCAL TAXES PAID BY SELECTED INDUSTRY GROUPS AS OF JANUARY, 1969[b]— ADJUSTED TO REFLECT PROPOSED CORPORATE NET INCOME TAX INCREASE TO 9½ PERCENT (by Pennsylvania Economy League)

INDUSTRY GROUP	Total State-Local Taxes 1969[b]	Total State-Local Taxes CNI Incr. From 7.5% to 9.5%	State Taxes 1969[b]	State Taxes CNI Incr. From 7.5% to 9.5%	Local Taxes 1965
Primary Metals Industries	10	8	5	2	10
Food & Kindred Products	10	8	6	4	10
Apparel & Other Products	9	9	5	4	10
Chemicals and Allied Products	9	6	3	1	10
Fabricated Metal Products	9	8	4	3	10
Electrical Machinery Equip. & Supplies	8	7	4	1	10
Instruments & Related Products	6	4	3	1	10

Note: States ranked from high to low in terms of tax dollars paid.

[a] Includes Delaware, Illinois, Indiana, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania and West Virginia.

[b] Updated to reflect state and local non-property taxes and tax rates as of January 21, 1969; data not readily available to permit current updating of property taxes.

Source: Pennsylvania Economy League, Inc., *Taxes Paid by Industry,* December 1967. Pennsylvania Economy League, Inc., *A Supplement to Taxes Paid by Industry,* March 1969.

TABLE 5-7

RELATIVE TAX RANKING OF THE SELECTED LOCATIONS FOR EACH OF FIVE HYPOTHETICAL CORPORATIONS (by Citizens Research Council of Michigan)

RANKING	TYPE A CORPORATION: Low inventory, Low capital investment, High labor content, Low profit, 152 employees — CITY	TOTAL TAX BURDEN	TYPE B CORPORATION: Low inventory, High capital investment, Medium labor content, Medium profit, 212 employees — CITY	TOTAL TAX BURDEN
1	Newark	$28,859	Milwaukee	$99,961
2	Milwaukee	24,272	Detroit	78,762
3	Indianapolis	22,114	Newark	76,864
4	Detroit	20,977	Cleveland	66,634
5	Cleveland	20,319	Indianapolis	63,964
6	Buffalo	19,602	Buffalo	61,308
7	Philadelphia	17,363	Philadelphia	56,309
8	Chicago	16,253(A)	Chicago	42,187(A)

TYPE C CORPORATION: High inventory, Low capital investment, High labor content, Medium profit, 150 employees — CITY	TOTAL TAX BURDEN	TYPE D CORPORATION: High inventory, High capital investment, Medium labor content, Medium profit, 94 employees — CITY	TOTAL TAX BURDEN	TYPE E CORPORATION: High inventory, High capital investment, Medium labor content, High profit, 94 employees — CITY	TOTAL TAX BURDEN
Milwaukee	$50,172	Milwaukee	$77,619	Milwaukee	$92,439
Detroit	48,194	Detroit	71,978	Detroit	87,940
Newark	43,050	Cleveland	69,933	Cleveland	71,245
Cleveland	42,959	Indianapolis	54,992	Newark	58,851
Indianapolis	38,339	Newark	48,226	Indianapolis	57,886
Buffalo	33,488	Chicago	38,883(A)	Buffalo	53,518
Philadelphia	30,438	Buffalo	36,018	Philadelphia	49,688
Chicago	29,188(A)	Philadelphia	33,333	Chicago	38,883(A)

(A) As estimated, based on assessed values determined pursuant to local custom.

Source: Citizens Research Council of Michigan, *Taxes on Industry and Individuals—Michigan Compared to the Competitor States* (1969).

Chapter III

Restructuring the System

As a guide to the evolution of tax policy, it is helpful to consider the extent to which New Jersey taxes business as compared with individuals, although this again implies a choice of the impact rather than the incidence of the tax for examination. This can be done in two ways: by a direct comparison among the states of the percentage of state and local taxes paid directly by business; and secondly, by establishing the **revenue capacity** of the state as the amount of money that would be raised if the state were making use, at national average rates, of each of the numerous kinds of revenue sources employed by state and local government. It is then possible to compare states according to the percentage of the revenue capacity so determined. This second approach is known as the "average-financing-system" analysis.

According to the most recently available comparable data, state and local taxes with an initial impact on business amounted to 32.6% of total state and local taxes—in 1967. In the same year the New Jersey percentage was 34.2%. This was a drop of 16.2% from the 1957 percentage, and does not take into account the subsequently developed revenues of the sales tax. In a highly urbanized state, it is to be anticipated that the tax yield from business will be proportionately greater than the national average. As shown in Table 5-8 there is a predominant tendency for the industrial states to run above the national average.

More recently, the ACIR[1] has developed the data for the average-financing-system approach, using 1966-67 patterns of taxation. As shown in Table 5-9, for the United States as a whole, the estimated total revenue capacity for state and local taxes is divided at 18% for business taxes (excluding local property taxes on farms) and 50.9% in personal taxes. The latter includes 15.3% of the total in local non-farm residential property taxes and 35.6% in other personal taxes (including general and selective sales taxes, individual income and earnings taxes, and death and gift taxes). The remainder of the revenue needs comes from other sources, of course. In New Jersey, the revenue capacity, measured the same way, is 19.3% from business taxes and 54.9% from personal taxes. Included in the latter is 17.4% of the total in local non-farm residential property taxes and 37.6% in other personal taxes.

[1] Advisory Commission on Intergovernmental Relations.

Based upon these capacities, the ACIR method then measures the percent relation of actual revenues to the estimated revenue capacity, to derive a measure of relative tax effort. These measures of relative tax effort, as of 1966-67, are as follows:

New Jersey Taxes as a Percent of Relative Capacity

Business taxes—85%
Local non-farm residential property taxes—176%
Other personal taxes—68%
Total personal taxes—102%

The Committee has considered the possibility of distributing the tax burden according to a so-called "model" tax system. The difficulty is that there is no consensus about the specifics of a model, either in the literature or experience. Thus, instead of developing a model concept, the average practice throughout the United States (or the average financing approach used above) provides an empirical guide to a reasonable distribution of the burden.

Income Elasticity Approach

An income elasticity approach confirms the direction suggested by the average financing approach. Both indicate an over-use of the property tax and insufficient use of personal income taxes. From the viewpoint of elasticity of the entire system, the key cause of the revenue gap projected in Part I has been shown to be a large disparity between the income elasticities of revenue and expenditures of the State.

"Income elasticity" is a measure of the extent to which a given degree of annual change in the aggregate income received by individuals in the State is accompanied by an annual change in the yield of the revenue source under study. Thus an income elasticity of 1.0 for a given revenue source says that for each 1% change in personal income in the State, the revenue yield of the system will change 1%. In effect, the income received by individuals is a measure of economic activity and economic growth which is normally accompanied by growth in State and municipal expenditures.

TABLE 5-8

RELATIONSHIP OF STATE AND LOCAL TAXES WITH AN INITIAL IMPACT ON BUSINESS TO TOTAL STATE AND LOCAL TAXES, BY STATE, 1957, 1962, AND 1967[1,2]

(Including Estimated General Sales Taxes)

(Dollar amounts in millions)

States	Total State and local taxes			State and local taxes on business[2]			Taxes on business as % of total taxes			
	1967	1962	1957	1967	1962	1957	1967	1962	1957	% change 1957-1967
United States	$61,000.3	$41,554.2	$28,645.1	$19,900.1	$14,478.2	$10,553.2	32.6	34.8	36.8	—11.4
Alabama	677.4	436.7	318.4	195.5	128.9	98.3	28.9	29.5	30.9	— 6.5
Alaska	85.8	52.4	n.a.	24.5	16.8	n.a.	28.6	32.1	n.a.	n.a.
Arizona	523.7	328.0	182.6	164.9	115.4	67.4	31.5	35.2	36.9	—14.6
Arkansas	392.5	254.8	177.5	99.8	70.7	54.5	25.4	27.7	30.7	—17.3
California	7,785.2	5,142.9	3,304.0	2,670.0	1,835.6	1,234.0	34.3	35.7	37.3	— 8.0
Colorado	677.7	475.7	313.2	214.8	161.4	107.7	31.7	33.9	34.4	— 7.8
Connecticut	982.6	684.0	460.8	337.3	253.9	166.2	34.3	37.1	36.1	— 5.0
Delaware	177.6	112.3	58.6	51.2	34.3	16.3	28.8	30.5	27.8	+ 3.6
Dist. of Columbia	274.9	183.0	142.7	87.4	60.1	48.4	31.8	32.8	33.9	— 6.2
Florida	1,623.1	1,061.3	663.3	476.2	366.6	235.1	29.3	34.5	35.4	—17.2
Georgia	1,025.0	627.4	467.9	304.7	198.9	143.6	29.7	31.7	30.7	— 3.3
Hawaii	300.5	173.8	n.a.	68.9	43.3	n.a.	22.9	24.9	n.a.	n.a.
Idaho	205.2	136.4	99.8	68.8	46.0	34.4	33.5	33.7	34.5	— 2.9
Illinois	3,249.6	2,461.9	1,723.7	962.6	787.6	584.8	29.6	32.0	33.9	—12.7
Indiana	1,471.3	951.1	635.3	433.7	363.5	236.5	29.5	38.2	37.2	—20.7
Iowa	918.9	638.3	487.6	192.7	156.6	114.1	21.0	24.5	23.4	—10.3
Kansas	717.1	518.6	367.4	209.3	165.2	119.6	29.2	31.9	32.6	—10.4
Kentucky	674.2	466.8	323.1	163.5	131.1	93.9	24.3	28.1	29.1	—16.5
Louisiana	958.8	655.1	497.2	529.8	370.6	257.8	55.3	56.6	51.9	+ 6.6
Maine	253.2	197.3	140.0	74.3	57.5	43.9	29.3	29.1	31.4	— 6.7
Maryland	1,172.4	713.8	460.2	319.1	207.5	141.5	27.2	29.1	30.7	—11.4
Massachusetts	2,004.2	1,422.7	1,014.9	556.1	440.6	341.2	27.7	31.0	33.6	—17.6
Michigan	2,715.2	1,896.2	1,391.9	974.2	747.6	556.7	35.9	39.4	40.0	—10.3
Minnesota	1,256.4	868.6	597.9	409.3	311.4	237.6	32.6	35.9	39.7	—17.9
Mississippi	461.3	316.8	233.5	156.8	121.9	87.8	34.0	38.5	37.6	— 9.6
Missouri	1,198.9	818.6	551.2	337.1	245.4	178.1	28.1	30.0	32.3	—13.0
Montana	212.8	162.1	125.4	76.4	60.7	48.6	35.9	37.4	38.8	— 7.5
Nebraska	389.6	270.7	200.1	77.1	58.2	46.5	19.8	21.5	23.2	—14.7
Nevada	166.2	95.2	59.9	62.0	35.0	24.1	37.3	36.8	40.2	— 7.2
New Hampshire	176.9	125.5	86.6	45.1	35.1	27.5	25.5	28.0	31.8	—19.8
New Jersey	2,239.8	1,507.9	987.1	766.1	561.4	402.7	34.2	37.2	40.8	—16.2
New Mexico	271.8	187.2	127.6	102.3	77.1	43.2	37.6	41.2	33.9	+10.9
New York	8,423.6	5,451.5	3,711.6	2,833.2	1,868.0	1,385.6	33.6	34.3	37.3	— 9.9
North Carolina	1,129.3	738.8	501.5	356.8	243.5	177.5	31.6	33.0	35.4	—10.7
North Dakota	178.4	134.9	107.8	45.4	34.7	27.8	25.4	25.7	25.8	— 1.6
Ohio	2,612.1	1,980.2	1,398.2	945.6	740.0	486.1	36.2	37.4	34.8	+ 4.0
Oklahoma	629.0	458.1	344.7	217.9	154.0	127.5	34.6	33.6	37.0	— 6.5
Oregon	631.3	417.9	347.9	201.8	144.0	123.2	32.0	34.5	35.4	— 9.6
Pennsylvania	3,241.8	2,335.6	1,769.8	1,043.1	771.2	714.3	32.2	33.0	40.4	—20.3
Rhode Island	266.9	188.7	129.7	85.3	59.1	46.1	32.0	31.3	35.5	— 9.9
South Carolina	510.8	330.6	244.8	170.1	104.0	80.3	33.3	31.5	32.8	+ 1.5
South Dakota	204.5	152.2	112.2	44.8	32.9	23.4	21.9	21.6	20.9	+ 4.8
Tennessee	820.7	528.3	402.8	255.1	166.3	125.3	31.1	31.5	31.1	0
Texas	2,471.2	1,850.8	1,253.3	1,034.4	866.4	652.6	41.9	46.8	52.1	—19.6
Utah	299.6	205.1	136.3	99.6	77.5	56.8	33.2	37.8	41.7	—20.4
Vermont	133.9	92.1	64.5	32.2	24.1	17.3	24.0	26.2	26.8	—10.4
Virginia	1,070.7	623.5	423.0	311.5	213.6	157.6	29.1	34.3	37.3	—22.0
Washington	1,108.6	759.6	511.8	380.0	268.6	186.2	34.3	35.4	36.4	— 5.8
West Virginia	400.4	306.4	218.9	156.7	119.4	97.0	39.1	39.0	44.3	—11.7
Wisconsin	1,517.6	974.6	706.6	427.1	293.9	250.5	28.1	30.2	35.5	—20.8
Wyoming	110.3	82.0	60.3	48.1	31.5	26.2	43.6	38.4	43.4	+ 0.5

n.a. Data not available.

[1] Excluding unemployment compensation.

[2] Business taxes include an estimate of the portion of general sales taxes initially paid by business (20 percent).

Source: Estimates prepared by ACIR staff from data published by the Governments Division, U.S. Bureau of the Census, and U.S. Department of Agriculture; and supplementary data supplied by several States. ACIR, *State-Local Finances and Suggested Legislation* (1971 edition) Table 78, p. 152.

TABLE 5-9

United States

CAPACITY AND EFFORT MEASURES FOR "BUSINESS TAXES" AND "PERSONAL TAXES," BY STATES: 1966-67

States	Percent of estimated total revenue capacity					Measures of relative effort (percent relation of actual revenue to estimated revenue capacity)				
	"Business taxes"		"Personal taxes"			"Business taxes"		"Personal taxes"		
	Including local taxes on farm property	Excluding local taxes on farm property[1]	Total	Local nonfarm residential property taxes	Other "personal taxes"[2]	Including local taxes on farm property	Excluding local taxes on farm property[1]	Total	Local nonfarm residential property taxes	Other "personal taxes"[2]
United States, Total	20.6	18.0	50.9	15.3	35.6	100	100	100	100	100
Alabama	18.3	15.9	49.4	14.0	35.4	53	57	101	28	131
Alaska	18.2	17.3	36.0	8.8	27.3	79	82	115	93	122
Arizona	19.1	15.2	47.0	13.4	33.6	92	106	108	107	112
Arkansas	21.4	14.7	50.1	13.6	36.5	72	79	87	39	105
California	18.3	16.1	52.4	18.4	34.0	140	141	98	106	94
Colorado	20.5	16.2	48.1	13.4	34.7	115	120	110	126	104
Connecticut	18.8	18.5	58.5	19.8	38.7	108	107	89	119	73
Delaware	20.7	19.6	53.2	16.1	37.1	91	93	92	62	105
Dist. of Columbia	17.5	17.5	60.9	17.9	43.0	88	88	89	72	96
Florida	16.1	14.0	55.2	18.7	36.6	87	86	80	72	85
Georgia	19.0	16.7	50.9	13.2	37.7	85	89	96	60	108
Hawaii	16.9	14.9	49.9	18.0	31.9	70	71	168	62	228
Idaho	25.0	14.6	44.2	8.5	35.7	124	149	100	44	114
Illinois	22.8	19.8	53.3	15.9	37.5	71	62	86	101	80
Indiana	23.2	19.4	49.1	12.2	36.9	91	85	98	104	96
Iowa	25.4	13.4	46.1	12.0	34.1	111	98	100	105	98
Kansas	24.6	16.2	45.1	13.8	31.2	106	104	90	77	96
Kentucky	20.6	16.8	51.7	15.2	36.5	59	61	97	51	116
Louisiana	28.7	26.5	38.6	9.8	28.8	102	109	83	17	105
Maine	17.5	16.3	55.5	15.8	39.7	115	108	102	112	99
Maryland	17.4	16.3	57.4	18.7	38.7	93	94	106	101	108
Massachusetts	18.0	17.9	54.5	16.5	38.1	130	129	115	166	93
Michigan	19.6	18.5	51.9	15.7	36.1	96	94	95	97	94
Minnesota	21.8	16.9	45.6	10.3	35.3	139	139	111	169	95
Mississippi	20.2	14.4	47.4	13.1	34.3	95	119	98	27	126
Missouri	22.3	18.2	52.7	14.1	38.6	72	69	89	85	90
Montana	28.3	15.5	41.8	8.9	32.9	114	143	75	87	72
Nebraska	22.9	11.7	43.5	12.3	31.3	90	68	54	94	38
Nevada	17.7	15.3	55.9	14.2	41.7	78	80	60	60	59
New Hampshire	15.0	14.4	59.8	18.5	41.3	97	94	79	139	52
New Jersey	19.6	19.3	54.9	17.4	37.6	86	85	102	176	68
New Mexico	23.4	18.5	38.6	9.1	29.6	72	85	98	35	118
New York	18.9	18.6	51.4	17.6	33.8	136	135	145	127	155

(continued)

To the extent that the yield of the tax system as a whole does not keep pace with such growth, it becomes necessary to increase tax rates or adopt new taxes as each year's revenue gap develops. As shown in Part I of the Report, the income elasticity of the present tax system of New Jersey is only .98 (Table 5-10) while government expenditures have an income elasticity of 1.50.

If the revenue system is to be made adequate to the needs of State and local government, steps should be taken to increase its income elasticity to 1.50 to match the State's expenditure elasticity.

TABLE 5-9 (continued)

United States

CAPACITY AND EFFORT MEASURES FOR "BUSINESS TAXES" AND "PERSONAL TAXES," BY STATES: 1966-67 (Cont'd)

States	Percent of estimated total revenue capacity					Measures of relative effort (percent relation of actual revenue to estimated revenue capacity)				
	"Business taxes"		"Personal taxes"			"Business taxes"		"Personal taxes"		
	Including local taxes on farm property	Excluding local taxes on farm property[1]	Total	Local nonfarm residential property taxes	Other "personal taxes"[2]	Including local taxes on farm property	Excluding local taxes on farm property[1]	Total	Local nonfarm residential property taxes	Other "personal taxes"[2]
North Carolina	20.1	17.1	52.4	14.7	37.6	90	95	99	52	117
North Dakota	23.0	9.8	32.8	5.6	27.1	114	120	89	132	80
Ohio	21.4	19.8	52.9	16.1	36.9	90	88	77	85	73
Oklahoma	25.4	19.8	44.5	13.0	31.5	81	87	79	52	91
Oregon	18.9	15.6	49.0	15.0	34.0	126	119	94	99	92
Pennsylvania	22.4	21.6	53.2	14.9	38.3	80	78	107	121	101
Rhode Island	17.6	17.4	54.8	15.7	39.1	112	111	101	130	89
South Carolina	19.4	16.9	49.4	9.0	40.3	97	104	103	30	119
South Dakota	26.3	9.6	40.4	8.3	32.1	114	119	107	181	88
Tennessee	18.9	16.2	49.1	13.4	35.7	81	86	92	75	99
Texas	27.2	22.7	45.1	9.7	35.9	84	90	67	89	61
Utah	21.4	18.2	47.0	14.1	32.8	106	112	113	75	129
Vermont	19.4	16.4	54.2	12.2	41.9	126	117	113	142	105
Virginia	22.0	19.7	68.8	18.7	46.4	72	72	90	57	105
Washington	17.6	15.2	46.9	16.2	30.7	61	55	121	52	157
West Virginia	24.1	23.1	49.7	13.2	36.5	46	45	116	53	139
Wisconsin	19.7	16.8	50.1	14.9	35.2	128	120	123	121	124
Wyoming	31.4	23.6	36.6	9.2	27.3	71	77	64	42	71

[1] Comprising corporation taxes, severance taxes, and local property taxes on business property.

[2] Comprising general and selective sales taxes, individual income and earnings taxes, and death and gift taxes.

Source: ACIR, *Measuring the Fiscal Capacity and Effort of State and Local Areas* (1971) Table G-6, p. 130.

TABLE 5-10

INCOME ELASTICITIES OF NEW JERSEY REVENUES

Revenue Source	Elasticity
Motor Vehicle	.73[a]
Motor Fuels	.62
Transfer Inheritance	1.19
Alcoholic Beverage	.61
Corporation Net Worth	.83
Corporation Net Income	1.49[b]
Foreign Insurance Corporation	1.24
Public Utility Surtax	.83[c]
Parimutuel Racing	.48
Cigarette Tax	.35
Emergency Transportation Tax	1.86[d]
Misc. Taxes & Fees	1.23
Department Sales & Services	1.60
Other Sources	1.28
Sales Tax	1.44[e]
Total Revenues	.98

Source: Computed by Committee staff.

Note: [a] yrs. 57-69
[b] yrs. 60-69
[c] yrs. 64-69
[d] yrs. 63-69
[e] N. J. tax estimated from Ohio's sales tax and regressed against N. J. income. Ohio sales tax regressed against Ohio income yields elasticity of 1.03.

Progressivity Approach

Progressivity of a tax system is closely related to income elasticity in that the more progressive the system the more income elastic it is likely to be. In addition, people tend to evaluate the tax system according to its progressivity, that is, in relation to its impact on the income to the taxpayer, as the measure of ability to pay.

Implicit in the use of an income measure of ability to pay is the assumption that the larger the income the less the sacrifice for each incremental dollar of tax payment. Starting from this theory, the effect of a tax system, or of an individual tax, may be described as either regressive, proportional or progressive.

Progressivity Indices A progressive tax may be defined as one in which the effective tax rate (the ratio of taxes paid to income) increases as income increases. A proportional tax may be defined as one for which the effective rate remains constant as income increases; and a regressive levy is one in which the tax rate decreases as income increases. Few taxes appear to conform precisely to such simple definitions. In many cases, the effective tax rate neither increases nor decreases continuously throughout the income distribution. Upward and downward movements of the effective

TABLE 5-11

State of New Jersey

PROGRESSIVITY INDICES OF MAJOR STATE AND LOCAL TAXES[2]

USING FISCAL 1971 SALES TAX YIELD AND FISCAL 1970 YIELD FOR OTHER MAJOR TAXES

Tax	Unweighted	(1) Weighted by Relative Population Shares
Property Taxes	.53	.55
Corporation Business Taxes	1.16	1.06
Sales and Use Tax	.85	.93
Public Utility Taxes	.61	.66
Motor Fuels Taxes	.67	.77
Motor Vehicle Fees	.80	.86
Insurance Taxes	.79	.92
Tobacco Taxes	.31	.31
Alcoholic Beverage Taxes	.84	1.01
Spectator Admission Taxes	.89	1.04
Inheritance-Estate Taxes	1.60	2.16
Other Taxes	.71	.99
Total Taxes	.64	.68
Total Taxes Excluding Property Taxes	.80	.86

[1] weight according to number of people in each income class.

[2] after giving effect to "exporting" through deduction from federal income tax base.

TABLE 5-12

State of New Jersey

PROGRESSIVITY INDICES OF MAJOR STATE AND LOCAL TAXES

WITH NO PROVISIONS FOR EXPORTING DUE TO OFFSETS AGAINST FEDERAL TAXES

Tax	Unweighted	(1) Weighted by Relative Population Shares
Property Taxes	.56	.58
Corporation Business Taxes	1.26	1.12
Sales and Use Tax	.86	.95
Public Utility Taxes	.62	.67
Motor Fuels Taxes	.67	.77
Motor Vehicle Fees	.80	.86
Insurance Taxes	.79	.92
Tobacco Taxes	.31	.31
Alcoholic Beverage Taxes	.84	1.01
Spectator Admission Taxes	.89	1.04
Inheritance-Estate Taxes	1.59	2.12
Other Taxes	.71	.99
Total Taxes	.69	.72
Total Taxes Excluding Property Taxes	.87	.91

[1] weight according to number of people in each income class.

tax rate between income classes cause problems in determining whether a levy is progressive or regressive as well as the degree of progressivity.

Because of the difficulties described above, we have employed a statistic which shows whether a particular tax is, *on the average*, progressive, proportional, or regressive. This statistic has been classified as a progressivity index and it measures the rate at which tax payments vary with respect to changes in income throughout the income distribution.[1] Two sets of such indices have been computed for each tax. In the first set, all income classes are weighted equally; in the second, each income group is weighted according to its relative importance with regards to population. Depending upon whether the index exceeds, equals, or is less than 1, a tax is classified as progressive, proportional, or regressive. Moreover, the higher the index, the more progressive the levy. Correspondingly, an index number considerably below 1, would imply a particularly regressive tax.

As shown in Table 5-11, the property tax has a progressivity index of .55 whereas inheritance and estate taxes have a progressive index of 2.16. The total present system has a progressivity of .68, but excluding the property tax raises the index to .86. As shown in Table 5-12 if the offset against Federal income tax is disregarded the progressivity index is increased somewhat. Table 5-13 compares the progressivity of the present system, with and without the property tax, to the Federal income tax.

In order to improve the progressivity index it would be necessary to shift from property taxation to non-property taxation, to improve the progressivity of existing non-property taxes by various changes, to give greater emphasis to progressive rate structures, or to use combinations of these measures.

[1] The formulas for deriving the indices are elaborated on in Jeffrey M. Schaefer, "Sales Tax Regressivity Under Alternative Tax Bases and Income Concepts," *National Tax Journal*, XXII (Dec. 1969), p. 520.

TABLE 5-13

State of New Jersey

PROGRESSIVITY INDICES OF MAJOR STATE AND LOCAL TAXES AND THE FEDERAL INDIVIDUAL INCOME TAX

Tax	(1) Unweighted	(2) Weighted by Relative Population Shares
Property Taxes	.53	.55
Corporation Business Taxes	1.16	1.06
Sales and Use Tax	.85	.93
Public Utility Taxes	.61	.66
Motor Fuels Taxes	.67	.77
Motor Vehicle Fees	.80	.86
Insurance Taxes	.79	.92
Tobacco Taxes	.31	.31
Alcoholic Beverage Taxes	.84	1.01
Spectator Admission Taxes	.89	1.04
Inheritance-Estate Taxes	1.60	2.16
Other Taxes	.71	.99
Total Taxes	.64	.68
Total Taxes Excluding Property Taxes	.80	.86
Federal Individual Income Taxes	1.59	1.57
State-Local Taxes Plus Federal Individual Income Taxes	1.07	1.06
State-Local Taxes Plus Federal Individual Income Taxes Less Property Taxes	1.32	1.31

Equity

The equity of a tax system is difficult to evaluate in universally accepted terms. Given the approach to income elasticity and progressivity adopted by the Committee, equity would demand a balanced use of three measures of tax contribution: accumulated wealth (property), spending and current income. For purposes of state and local finance, moreover, relative stability of yield is an absolute requirement, since a state cannot engage in deficit financing like the Federal government. Income tax rates, unlike property tax rates, may not rationally be increased when income falls, since this would become counterproductive much sooner than with property taxation.

The various goals of tax reform which have been described by the Report suggest a pattern for redistribution of the total state-local burden using each of the three measures of taxation in moderation. Accordingly, an approach to the goal of massive reduction of the total property tax burden would include an equal use of property, sales and income taxes, so that ⅓ of the $3.9 billion of taxes collected in 1971 would be from property taxation and the remainder from income and sales taxes.

The Committee Recommends:

As a present goal, at least until the effects the proposed restructuring of the tax system, together with possible Federal take-over of welfare or revenue sharing, are achieved and stabilized, that the State shift to a state-local revenue system using no more than 1/3 property taxes, the balance from non-property taxes.

The Committee Further Recommends:

Replacement revenues for the property tax shall be sought from income elastic sources with progressive rate structures, sufficient to overcome the deficiencies of the present tax structure; and

Specific tax sources should be selected, following these principles, and with due regard to comparative tax burdens, from both business and personal levies which are examined in the chapters which follow.

Section B
Taxation of Business

Effect of Property Tax Reductions

The taxation of business in the most urbanized state in the nation presents a peculiarly complex area of public policy. On the one hand, business property in an industrial state is certain to represent large investments and is expected to contribute accordingly to the yield of a property tax system. On the other hand, the people of an urbanized state depend upon business and industry for employment and for the economic health of the state. It is thus important to maintain a tax burden on industry which is competitive with other states, since industry has the option of locating or expanding in one state or another, and its choices affect the tax base as well as employment and payrolls.

At a recent symposium of the Tax Institute of America, Professor John F. Due, of the University of Illinois, summarized the problem as follows:

> "Classification of taxes on the basis of whether they are 'on business' or 'not on business' and thus on individuals is a meaningless and dangerous exercise, as there is no possible scientific basis for drawing a significant line between the two categories . . .
>
> The significant questions about taxes affecting businesses are: What are the effects of a given state-local tax structure upon business firms in general and in particular industries? What significance do these effects have for economic development of the state and for desired distributional patterns? What changes would eliminate the evils? The worst offenders appear to be the part of the property tax on business firms, the state business and occupation taxes based on gross receipts, the portion of the sales tax applying to business purchases, and corporation income taxes far out of line with those of other states competitive for industry."

Without challenging the validity of Professor Due's conclusions, the Committee recognizes that there is a practical interest in a comparison of the expected tax savings by "business" or "industry" as compared with the additional tax burden this segment of the economy would be required to pay under the Committee's recommendations. The analysis of tax collections by 567 municipalities reported in Part II of the Report, shows that commercial and industrial taxpayers (including apartment owners) paid about 33% of the total property tax collections in 1971. From this it might be concluded, the Committee believes erroneously, that business will realize a tax saving of $272 million in property tax. If this figure is compared with the $90 million in increased corporate income tax recommended by the Committee, it might appear that "business" will realize a $180 million tax windfall. There are several reasons why this would not be a correct conclusion:

1. Apartments will realize 22% of the property tax reduction credited to business, or approximately $60 million.
2. The individual income tax will be paid in part by business to the extent that partnerships and individual proprietorships pay the tax, and such business entities also appear as owners of real estate in the business category. It is estimated that such payments under individual income tax, which offset savings on business real estate, would amount to about 15% of the total income tax yield, or $82 million.
3. Since income producing property is usually valued by the income capitalization method, and the capitalization rate includes the local tax rate, any reduction in the local tax rate will immediately result in an increase in the assessed valuation of the property. Such increases on business property will cause part of the tax burden of the municipality to be shifted from non-income producing property, such as homes, to the business property. Upon the basis of preliminary tests, it appears that this shift in the average municipality may amount to between 1% and 3% of the local tax burden. Assuming a 2% shift, this will reduce the business tax saving from the Committee's recommendations by $28 million.
4. The recommended increase in the corporate income tax rate will offset total real estate tax savings of $90 million.

These are gross figures, and the trouble is that they do not represent the effect of the program on any real taxpayer. It is anticipated that some business firms will receive large tax savings and others may actually pay more. Much depends on the municipality in which they are now located, whether they are capital intensive or labor intensive, and how profitable their operation has been. In a sampling of twelve major corporations made for the Committee, nine taxpayers had no windfall to report, one broke even, and one would realize a windfall and one would actually pay substantially more tax under the program. No conclusions can be drawn from such a small sample, of course, but it does illustrate the fallacy of generalizing as to "business" impact of the tax program.

If indeed there will be windfalls to business as a result of the Committee's recommendations, the bulk of them will occur in the big six cities. This is precisely where massive tax reduction for all taxpayers, including business, would be the most beneficial. As a matter of tax policy, the net reductions in tax burden, which will be realized by commercial and industrial property in the core cities, will represent a most desirable investment in the future of those cities.

The Committee concludes that there is no significant windfall problem from the point of view of the taxation of business, and major tax savings to be realized by individual business taxpayers are most likely to occur in areas where they are most needed to sustain the economic viability of older cities.

The Committee recommends:

To provide further assurance on the windfall question, the division of taxation should make a study of future tax returns and, after a reasonable period of experience, report to the legislature on the actual impact of the committee's program, with respect to shifts in the property tax burden and total tax burden of business as compared with tax payers generally.

Chapter IV

Corporation Business Tax

To state the Committee's conclusions at the outset, we recommend that:

(1) The corporation net income tax rate should be increased from the current 4-1/4% of taxable income to 7-1/4% beginning in 1972, and no higher.

(2) The net worth tax rate should remain unchanged from the current rates of 2 mills per dollar on the first $100 million of taxable net worth, and decreasing by steps to the lowest rate of 2/10 of a mill per dollar on taxable net worth in excess of $300 million.

In reaching these conclusions, we have proceeded on the premise that, in general, the net income measure of the corporate tax commends itself, because it imposes the levy in accordance with actual profits earned, whereas the net worth tax, which is essentially a levy measured by net property owned, is payable regardless of profit, and is, accordingly, levied on old corporations including those that experience losses during the taxable year. Moreover, the tendency in State taxation in recent years has been to rely more and more on corporate income taxes. It is noteworthy that Ohio and Florida in 1971, for the first time adopted corporate income taxes measured by net income (See Table 5-14).

Nevertheless, the net worth tax has a legitimate place in the State's corporate tax system. As is set forth below, reliance on the corporate income tax alone presents fiscal dangers to the States during years of economic decline, whereas the yield of the net worth tax is not significantly affected by fluctuations in income. The State's services must go on during poor times, as well as in prosperous periods. Furthermore, the Governor and the Legislature are required under our constitution and fiscal laws—like those of other States—to provide the revenues, year by year, for that year's expenditures. To eliminate entirely the net worth tax—which for 1970 produced some $52 million in revenues would, in our view, be taking an unwarranted risk in providing fiscal resources to meet the constitutional obligations of the State and local governments annually to raise the revenues required to meet expenses.

The net worth tax also commends itself on the merits, when levied, as is being now done, on a relatively modest basis. Many of the State and local functions, which must be paid for out of State-wide tax revenues, benefit business enterprises; indeed, they provide the essential infrastructure of the State which businesses need in order to operate. It is entirely appropriate that these governmental functions and services, which must go on, regardless of the stage of the business cycle which businesses are experiencing, be contributed to by the corporate businesses in the State; the net worth tax is an effective vehicle for that purpose.

Finally, the sheer weight of a long history supports the net worth tax. It existed many decades before the comparative newcomer, the net income tax, became part of our law in 1958. Businesses have, as a result, gotten accustomed to paying the tax to meet the State's needs in depressions, and during business booms. The importance of this traditional acceptance of the levy takes on added significance in the light of the obvious alternative to the net worth tax—an increase in the corporate income tax rate. Our studies disclose that if the net worth tax were to be eliminated, in order to replace the revenues thus lost without raising any additional revenues, the corporation net income tax would have to be increased by 1.8 percentage points.

Having concluded that the net worth tax rate should be retained at its current rate and that the net income tax rate should be increased, we considered the question of how far, if at all, that rate should be raised. In doing so, we took into account the burden of corporate taxation in New Jersey, the comparative taxes paid in neighboring and other competing States, the State's revenue needs, and the like. The studies of comparative business tax burden have indicated that this State will compare favorably in business tax climate. Most of the other States are rapidly increasing corporation

TABLE 5-14
STATE CORPORATION INCOME TAX RATES, DECEMBER 31, 1971

State	Rate (percent)		Federal tax deductible[1]	Related provisions
Alabama		5	X	
Alaska	First $25,000	5.4	—	
	Over $25,000	9.36		
Arizona[2]	First $1,000	2	X	
	$1,001-$2,000	3		
	$2,001-$3,000	4		
	$3,001-$4,000	5		
	$4,001-$5,000	6		
	$5,001-$6,000	7		
	Over $6,000	8		
Arkansas	First $3,000	1	—	
	$3,001-$6,000	2		
	$6,001-$11,000	3		
	$11,001-$25,000	5		
	Over $25,000	6		
California**		7.6	—	Minimum tax: $100.
Colorado		5	—	Alternative tax: Any person required to file a Colorado income tax return (1) whose only activities in Colorado consist of making sales, (2) who does not own or rent real estate within the State, and (3) whose annual gross sales in or into the State amount to not more than $100,000 may elect to pay a tax of ½ of 1% of his annual gross receipts derived from sales in or into Colorado in lieu of paying an income tax.
Connecticut[2]		8	—	If tax yield is greater, 4 mills per dollar of capital employed in Connecticut. Minimum tax: $45. Banks and financial institutions, 8% of net income or 4 mills per dollar of average par or face value of indebtedness plus average value of issued and outstanding stock plus average value of surplus reserves and undivided profits less average value of deficits on private stock holdings.
Florida**		5		
Delaware		6	—	
Georgia		6	—	
Hawaii[2]	First $25,000	5.85	—	Capital gains entitled to alternative tax treatment are taxed at 3.08%. Financial institutions, 11.7%.
	Over $25,000	6.435		
Idaho		6	—	A $10 filing fee is imposed.
Illinois		4	—	A standard exemption of $1,000 is allowed every taxpayer.
Indiana		2	—	
Iowa	First $25,000	4	X[3]	Financial institutions: 1st $25,000 of net income, 5%; next $15,000, 6%; next $25,000, 7%; over $100,000, 8%.
	$25,001-$100,000	6		
	Over $100,000	8		
Kansas		4.5	X	Banks, trust companies and building and loan associations, 5%.
	Plus a 2¼% surtax on taxable income in excess of $25,000.			
Kentucky	First $25,000	5	X	
	Over $25,000	7		
Louisiana		4	—	
Maine		4	—	Alternative tax: A corporation, in lieu of paying the 4% tax on allocated and apportioned net income, may pay a tax of 1% of gross sales in Maine if, during the taxable year, the corporation neither owns nor rents tangible property in Maine, the corporation's activities in Maine are limited to sales, and the gross sales of the corporation in Maine do not exceed $100,000.
Maryland		7	—	Domestic corporations are allowed credit for franchise taxes in excess of $40.
Massachusetts[2]		7.5[4]	—	Plus $7 per $1,000 upon the value of its tangible property not subject to local taxation and situated in Massachusetts on the last day of the taxable year if a tangible property corporation (or its net worth allocable to Massachusetts if an intangible property corporation). Minimum tax $100. Domestic corporations pay a tax of ⅓ of 1% of the value of their interest in ships in interstate or foreign commerce, which value is deducted from the corporate excess. Taxes computed under any of the bases subject to a 14% surtax.
Michigan		5.6	—	Financial institutions, 7%.
Minnesota**		12.33	X	A credit of $500, deductible from net income, is allowed each corporation. Minimum tax: $10. Banks, 13.64%.
Mississippi	First $5,000	3	—	
	Over $5,000	4		
Missouri**		5	X	Banks and financial institutions, 7%
Montana		6.25	—	Minimum tax, $50, except $10 for small business corporations.

State	Rate (percent)	Federal tax deductible[1]	Related provisions
Nebraska[2]	2.6 (2.0 eff. 1/1/71)	—	The tax rate is 20% of the rate applicable to individuals. The rate for individuals for 1970 is 13% and is set as a flat percentage by the State Board of Equalization and Assessment on or before November 15 annually for the taxable year beginning during the subsequent calendar year.
New Hampshire**	6	—	
New Jersey	4.25	—	All corporations pay additional tax on net worth.
New Mexico[2]	5	—	Banks and financial institutions, 6%.
New York**	9 percent plus tax of ⅝ mill per $1 of allocated subsidiary capital. (There is an additional tax of 5¼% of business income on omnibus corporations which have gross receipts of $500,000 or more for the taxable year within New York from omnibuses having a seating capacity of more than 7 persons.)	—	Corporations are subject to the 7 percent tax on net income or a tax on 3 alternative bases, whichever is greatest. The alternative taxes are: (1) 1¼ mill on each dollar of business and investment capital; or (2) 7 percent of 30 percent of net income plus compensation paid to officers and holders of more than 5 percent of capital stock, less $15,000 and any net loss; or (3) $100, whichever is greatest; plus the tax on allocated subsidiary capital. Banks and financial institutions, 6%.
North Carolina	6	—	Banks and financial institutions, 6%.
North Dakota	First $3,000 ... 3 $3,001-$8,000 ... 4 $8,001-$15,000 ... 5 Over $15,000 ... 6	X	For taxable years beginning on and after January 1, 1970 foreign and domestic corporations will be subject to an additional 1% tax for the privilege of doing business in the State if (1) their personal property is not assessed by the State Board of Equalization, (2) they are not subject to a special tax in lieu of personal property taxes, and (3) they are required to file a North Dakota income tax return. The additional tax will apply to taxable income computed as provided under the income tax law except that federal income tax will not be deductible. Minimum tax, $20. Banks and trust companies, 5%. Effective January 1, 1970 an additional 2% tax is levied on State and national banks and trust companies for the privilege of transacting business in the State. Minimum tax, $50.
Ohio**	4-8		
Oklahoma[2]	4	X	Banks 4%.
Oregon	6	—	Manufacturers may claim an offset of up to one-third of the tax for Oregon personal property taxes paid on raw materials, goods in process, and finished products. Minimum tax: $10. Banks, national banking associations, financial institutions, and production credit associations, 8%.
Pennsylvania[2]**	12	—	
Rhode Island	8	—	Alternative tax: 40 cents per $100 on corporate excess, if tax yield is greater. Banks and financial institutions, 8% or $2.50 per $10,000, if tax yield is greater.
South Carolina	6	—	Banks, 4.5%, savings and loan associations, 8%.
South Dakota	Footnote 5.	—	
Tennessee[2]**	6	—	
Utah	6	X	Minimum tax: $25. Banks and financial institutions, 6%.
Vermont[2]	6	—	Subject to reduction if there is sufficient surplus in general fund. Minimum tax: $25. Banks and financial institutions, 6%.
Virginia	5	—	
West Virginia	6	—	
Wisconsin[2]**	2.1 to 7.4	X[6]	
District of Columbia	6	—	**Banks and trust companies, 4%; building and loan associations, 2%.**

* Source: State and Local Finances & Suggested Legislation (1971 Ed.), Advisory Commission on Intergovernmental Relations, pp. 96-99, which gives the information as of December 31, 1970, up-dated by Committee staff to December 31, 1971.

X Denotes "yes";

— Denotes "no."

[1] In general, each State which permits the deduction of Federal income taxes limits such deduction to taxes paid on that part of income subject to its own income tax.

[2] Allows deduction of State corporation income tax itself in computing State tax liability. This deduction was eliminated beginning with the year 1971.

[3] Limited to 60% of Federal income taxes paid or accrued during the taxable year.

[4] The rate shown is for business or manufacturing corporations (utility corporations,5%). Domestic and foreign security corporations (other than regulated investment or bank holding companies, which are taxed as the rate of ¼ of 1% of gross income or $100, whichever is greater) 1% of gross income or $100, whichever is greater. Domestic and foreign corporations engaged in interstate commerce and not subject to the corporation excise (income) tax, 4% on that portion of their net income derived from business carried on in the State. Plus a 14% surtax applicable to the taxes computed under any of the bases.

[5] Tax at 5.5% ($24 minimum) applicable to banks and financial institutions only.

[6] Limited to 10% of net income before Federal tax.

Source: Commerce Clearing House, *State Tax Reporter*.

** A number of States in 1971 enacted legislation increasing their corporate income tax rates, frequently effective as of 1972. These include the following States:

	Rate Change From	To		Rate Change From	To
California	7%	7.6%	New York	7%	9%
Florida	—	5% tax adopted in 1971	Tennessee	5%	6%
Minnesota	11.3%	12.33%	Wisconsin	2.1%	7.4% through 1972
Missouri	2%	5%		2.3%	7.9% later years
New Hampshire	6%	7%			

Ohio enacted an income tax law with rates ranging from 4% to 8%, effective 1972. In 1969 Pennsylvania adopted a 12% net income tax rates, which is to be reduced to 11% beginning as of July 1, 1972.

taxes, under the pressure of revenue needs. Our recommendation that the corporate income tax rate be increased 7¼%, and no more, is made in the light of all these factors. As Table 5-14 discloses, the New York State income tax rate has gone to 9% for 1972, Ohio to 8%; and Connecticut is at 8%, and Pennsylvania will impose an 11% tax beginning as of July 1, 1972.

In considering the proposed 7¼% corporate income tax rate, all aspects of the State tax structure must be taken into account. Based on 1971 yields the net worth tax may be translated into an average of approximately 1.8 percentage points of income tax rate, making a total of about 9%, the New York State rate, one percentage point above Ohio and Connecticut rates, and 2% below the 1972 Pennsylvania rate. The effect of the net worth tax on the income of particular corporations will vary with the rate of return on the stockholder's equity of the corporation. Thus the income tax equivalent is 2% (added to 7¼%) when the rate of return is 10%, and 1% (added to 7¼%) when the rate of return is 20% (in all cases disregarding net worth tax rates of less than 2 mills in the tax brackets). For any other rate of return the income tax equivalent can be calculated by dividing .002 by the rate of return. Corporations, like other businesses in the State, will benefit in varying degrees from the proposed reductions in the property tax and from proposed restoration of the exemption from sales and use tax for machinery used in production.

A Second Tier Direct Net Income Tax

Most of the States impose corporation taxes that are measured by net income (See Table 5-14.). Historically, the State corporation tax developed in this country as a privilege or franchise tax, a levy on the privilege of conducting business as a corporation. And when the traditional capital stock tax measure was supplemented or supplanted by a net income base, most of the States, including New Jersey, retained the franchise form of levy.

Because the constitutional reach of a franchise tax, even when measured by net income, is generally more limited than that of a direct net income tax as applied to out-of-state corporations engaged in interstate commerce, a number of States which levy a franchise tax have developed the so-called second-tier income tax.[1] We turn to an examination of the nature and impact of that tax instrumentality, in order to consider whether such a levy should become a part of the Corporation Business Tax of this State.

The second-tier corporate net income tax had its origin in decisions of the Supreme Court of the United States under the Commerce Clause, which restricted the power of the States to levy corporate franchise, or other excises, on the privilege of doing an exclusively interstate business in the State. These decisions grew out of the principle that the States could not, in view of the Commerce Clause, debar foreign corporations from carrying on interstate business within the State; and as a result, taxes on the privilege of doing an exclusively interstate business were likewise held invalid as an undue burden on the commerce.[2] A number of States sought to meet this constitutional objection by adding to their corporate franchise taxes, or by substituting for them, an income tax levied, not on the privilege, or the doing of business in the State, but on income derived from sources within the State.

California, for example, in 1937 added to its traditional franchise tax on doing business in corporate form, a supplemental levy (hence the term "second-tier") on corporations immune under the Commerce Clause decisions from the doing business taxes, a direct net income tax on income derived from sources within the State. This second-tier tax is in all major respects identical to the State's corporate franchise tax, using the same rate and the same division of income methods as in the franchise tax.[3]

The advantage to the State of retaining the franchise

[1] Second-tier taxes are imposed by California, Idaho, Massachusetts, Minnesota, Montana, Nebraska, Oregon, Pennsylvania, Utah, Wisconsin and the District of Columbia. See C.C.H. State Tax Guide, Par. 220. In addition, many States do not utilize franchise taxes, but only a direct net income tax, which covers corporations, including those taxable corporations doing an exclusively interstate business. See, e.g., Alaska, Arizona, Georgia, Illinois, Maryland, Missouri and Nebraska. Idem.

[2] International Textbook Co. v. Pigg, 217 U.S. 91 (1910); Sioux Remedy Co. v. Cope, 235 U.S. 197 (1914); Alpha Portland Cement Co. v. Massachusetts, 268 U.S. 203 (1925); Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951).

[3] The California Bank and Corporation Franchise Tax, Chapter 2, imposes a tax, measured by net income "for the privilege of exercising its corporate franchises within this state." Calif. Revenue and Taxation Code, Sec. 23,151. Another section, Chapter 3 of the same Code, imposes a tax on "every corporation . . . upon its net income derived from sources within this state . . . , other than income for any period for which the corporation is subject to taxation under Chapter 2 . . ." Idem., Sec. 23,501. See, also, Secs. 24,271 and 24,272, Idem.

tax for the corporations to which it can be applied (which is the great majority of taxable corporations) lies in the power of the States to include in the measure of the franchise tax interest and other income from securities issued by the United States government and its instrumentalities, a power which the States lack under a corporate income tax. This difference in the reach of the two forms of tax is dictated by decisions of the United States Supreme Court dealing with State taxation of Federal instrumentalities.[4]

The second-tier income tax, as has been indicated, proved successful constitutionally, for the Supreme Court held that, unlike a franchise or privilege tax on the doing of an exclusively interstate business, a direct net income tax could be applied by the States to business engaged exclusively in interstate commerce, without running afoul the Constitution, provided Due Process Clause nexus requirements are satisfied.[5] These principles apply equally to States having only direct corporate net income taxes and those adopting second-tier direct income taxes to supplement corporate franchise taxes.

The 1959 decisions of the Supreme Court produced a widespread demand among multistate businesses for Congressional action to restrict the taxing powers of the States. The result was Public Law 86-272, which marked the first time in our history that Congress has exercised its broad constitutional power to regulate interstate commerce by restricting the power of the States to tax.[6] Under P.L. 86-272, the States are forbidden to impose on any foreign corporation or nonresident of the State, engaged in selling goods across State lines, any tax directly on or measured by net income, so long as the interstate vendor engages only in the minimum activities in the State protected by the statute. The applicable provisions of the statute are as follows:

> "Sec. 101. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> "(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
>
> "(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)."[7]

The constitutionality of this statute has been sustained by decisions of the Supreme Courts of the States in which it has been challenged.[8] Although the highest court has not passed on the issue on the merits, the validity of the Congressional enactment does not appear open to serious challenge.[9] While there has not yet been enough definitive litigation to answer a number of the inevitable problems of construing the statute, it is clear that by any likely construction, there is a consider-

[4] The Supreme Court has held that, whereas a direct State tax on interest from securities issued by the Federal government, or its instrumentalities, violates the inter-governmental immunities doctrine (Weston v. Charleston, 2 Pet. 449 (1829)), a State franchise tax measured by such interest, being an indirect levy on the interest, does not run afoul the doctrine (Flint v. Stone Tracy Co., 220 U.S. 107 (1911)). This distinction, which has been widely criticized, is now embodied in Congressional legislation (31 U.S.C. Sec. 742).

It is worth noting that the Board of Governors of the Federal Reserve System has recently recommended to Congress that the statute should be broadened so as to authorize the States to tax banks and other depositary institutions on the interest from the securities issued by the Federal government and its instrumentalities, under a direct corporate net income tax, as well as in the measure of a corporation franchise tax. See "State and Local Taxation of Banks", Report prepared by the Board of Governors of the Federal Reserve System (92d Cong., 1st Sess., May 1971), pp. 7-8.

[5] Northwestern States Portland Cement Co. v. Minnesota and Williams v. Stockham Valves and Fittings, Inc., 358 U.S. 450 (1959).

[6] 73 Stat. 555, 15 U.S.C., Sec. 381. For the history and background of the statute, see "State Taxation of Interstate Income", Hearings Before Senate Select Committee on Small Business (86th Cong., 1st Sess., 1959), and S. Rep. No. 453, ibid.; Hearings Before Senate Finance Committee, S. J. Res. 113, S. 2213 and 2281 (1959), and S. Rep. No. 658.

[7] P.L. 86-272, Sec. 101(a)(1). There is also within the minimum standard of non-taxation a provision for making sales through independent sales representatives, who act for more than one vendor.

[8] International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314, certiorari denied sub nomine Mouton v. International Shoe Co., 379 U.S. 902 (1964); Smith, Kline & French Laboratories, Inc. v. State Tax Commission, 241 Ore. 50, 403 P. 2d 375 (1965); State ex rel. Ciba Pharmaceutical Products, Inc. v. State Tax Commission, 382 S.W. 2d 645 (Mo. 1964).

[9] See Hellerstein, "The Power of Congress to Restrict State Taxation of Interstate Income", 11 Journal of Taxation 302 (1960).

able area of activities of exclusively interstate businesses, heretofore often untaxed under franchise levies, that remain within the reach of a direct net income tax.[10] Thus, any foreign corporation maintaining merely a sales office in New Jersey would presumably be taxable under a direct net income tax, whereas such a company would not ordinarily be taxable under a franchise-doing-business tax.[11] Within the interstate selling area, the recent *Clairol* case decided by the New Jersey court suggests that at least some State courts are giving P.L. 86-272 a rather narrow construction.[12] Moreover, the Federal statute does not restrict levies on transportation, banking, insurance, advertising, investment companies, securities brokerage, or any service industry, since it is confined solely to the selling of tangible personal property.

There have been persistent efforts in recent years to obtain the enactment of additional Federal legislation, which would both harmonize and further restrict State taxation of interstate business.[13] Thus far, these legislative efforts have been unsuccessful, doubtless to a considerable extent because a good many States have joined in the Multistate Tax Compact.[14] The Compact is designed in part to solve by voluntary, cooperative State action some of the more frequently voiced complaints against the lack of uniformity in the apportionment and allocation of the income of interstate business, but it does not generally restrict the taxing jurisdiction of the States.

We conclude that under the applicable constitutional provisions and existing Congressional restrictions on the taxing powers of the States, there is a good deal of room for broadening the scope of the Corporation Business Tax by enacting a second-tier net income tax.

The Committee Recommends:

Because we believe equity demands business carrying on activities in the State and exploiting the New Jersey market make some contribution to the costs of maintaining governmental operations and the services provided by the State, we recommend the adoption of a second-tier net income tax, as part of the Corporation Business Tax, to be applied to corporations deriving income from the State, which are not subject to the present franchise tax or income tax. Because of the lack of useful data, the committee does not recommend a specific revenue anticipation from this correction of inequity, but experience in other states suggests, possible revenue of $2 to $4 millions.

Net Worth Tax as a Minimum Alternative

The evolution of the present Corporation Business Tax was summarized in the *12th Report* of the Commission on State Tax Policy (pp. 34-35) and need not be retraced here. The current net worth tax as developed as a replacement for both the 1885 capital stock tax and the intangible property tax on corporations; the net income tax is a comparative newcomer in New Jersey corporate taxation, having been added to the Corporate Business Tax in 1958.

Over the decades, the tendency in State taxation has been to substitute the corporate net income tax for the traditional capital stock and net worth taxes, and in some States to retain the latter type of tax only as a minimum alternative levy to the net income tax. Nevertheless, there are a number of States that follow the New Jersey practice of imposing a two-pronged corporate net worth and income tax.[15]

There are serious deficiencies, from the point of view of the States, in employing the income tax alone in

[10] See Cal-Roof Wholesale, Inc. v. State Tax Commission, 242 Ore. 435, 410 P. 2d 233 (1966); Clairol v. Kingsley, 57 N.J. 199, 270 A. 2d 702 (1970).

[11] In Roadway Express, Inc. v. Director, Division of Taxation, 50 N.J. 471, 236 A. 2d 577, appeal dismissed, 390 U.S. 745 (1968), the New Jersey Supreme Court indicated it dissatisfaction with the holding of the Supreme Court of the United States that a franchise tax may not be imposed on a foreign corporation doing an extensive business in the State, albeit exclusively interstate. Nevertheless, the New Jersey Court found other grounds for distinguishing the cases applying that doctrine. Hence, the U.S. Supreme Court's dismissal of the taxpayer's appeal cannot be read as overruling the prohibition of franchise taxes on interstate businesses.

[12] See Note 10, supra.

[13] The Willis Subcommittee of the House Judiciary Committee, after an extensive five-year study, recommended that Congress curtail the powers of the States to tax interstate businesses beyond the restrictions imposed by P.L. 86-272. See "State Taxation of Interstate Commerce", H.R. Rep. No. 1480 (88th Cong., 2d Sess., 1964). Bills to achieve that end have been before Congress since 1965; one bill passed the House at an earlier session but not the Senate (H.R. 11798, 89th Cong., 1st Sess.), and several bills are now pending in the Congress (see the Rodino Bill, H.R. 1538, Int. Jan. 22, 1971, P-H State and Local Tax Serv., All States Unit, Par. 6401, and the Ribicoff Bill, S. 317, id. Par. 6541, Int. Jan. 27, 1971).

[14] There are now 21 States which have become parties to the Compact, and 15 States, including New Jersey, which are not parties to the Compact, but are non-voting Associate Members of the Multistate Tax Commission, which administers the Compact. See P-H State and Local Tax Serv., All States Unit, Pars. 5150-5151, for a listing of the parties to the Compact and the Associate Members, and Par. 6301 for the provisions of the Compact. On March 9, 1971, the State of New York withdrew as an Associate Member. The Magnuson Bill (S. 1883, Int. May 17, 1971), now pending in Congress, provides for Congressional consent to the Compact. Idem, Par. 6371.

[15] The existing capital stock taxes are enumerated in P-H State and Local Tax Service., Par. 1050, All States Unit. Some States have reduced the importance of the capital stock tax by adopting a comparatively low maximum levy, particularly where it is a tax on the number of shares of stock authorized or outstanding; such levies are not comparable to New Jersey's tax on the value of the corporation's capital stock, i.e., its net worth. Pennsylvania is one of the States which has a two-pronged net income and capital stock tax.

taxing corporations. The collections from the income tax fluctuate with economic changes. While a fluctuating levy is appropriate as a principal reliance for revenues by the Federal government, with its taxing powers and its vast borrowing power, which enables it to raise funds during downturns in the business cycle, for the States, which must continue their public servivces and have no comparable taxing or borrowing resources available to utilize during bad times, reliance on an income tax as the only base for corporate taxation presents far more serious dangers. In the preparation and adaptation of the State Budget, required by the Constitution to be balanced originally (N.J. Constitution, Art. VIII, Sec. 2; N.J. Stats. Ann., Secs. 52:27B-20 and 21) it is very desirable that some taxes be employed that can be reasonably relied upon to stabilize the estimated revenues needed to meet budgeted expenditures. The net worth tax has the advantage of providing stability in meeting this budgetary requirement.

That tax also commends itself on its own merit as a levy which, to some extent at least, is imposed in accordance with the ability to pay principle. The amount of property owned, the net worth of assets in a business is one measure of ability to pay. While we regard the net income tax as a more sensitive and more refined measure of ability to pay than the net worth tax, and recommend greater reliance on the income tax in our Business Corporation Tax structure, nevertheless, we are of the view that there are enough positive characteristics in the net worth levy to warrant its retention at the current modest level.

Finally, that tax has in its favor the sheer weight of history. A net worth tax has been employed in this State since 1884 (P.L. 1884, p. 232), as indeed, it was traditionally in the States over the country the principal measure of the corporation franchise tax. Businesses have become accustomed to paying the net worth tax, and have adjusted themselves to it. It ought not be discarded, particularly in a period of pressing revenue needs and an intensive search for new revenues, unless there are compelling reasons for doing so.

Moreover, if the State should eliminate the net worth tax, and increase the corporate income tax rate to a level required to raise the revenues thus lost, there would be a significant redistribution of the tax burden among the trades and industries in the State. Some businesses would find their taxes increased substantially and disproportionately, as compared with business in the State generally, while other industries would experience only slight increases, or even tax reductions.

Table 5-15, based on a study of selected 1968 Corporation Business Tax returns, shows that overall the net worth component of the business tax accounted for slightly in excess of one-fifth of the total corporation tax; the percentages, however, varied markedly industry-by-industry—38% for paper manufacturing, 36% for the retail food trade, and 30% for auto manufacturing, as compared to from 10%-15% for office equipment, food manufacturing and plant equipment. For the year 1970, the net worth tax raised approximately $52 million out of a total of $169 million in cash receipts by the Corporation Business Tax. If the 1968 study is representative of the distribution by industry classification in 1970, the elimination of the net worth tax, and the raising of the revenues thus lost by an increase in the corporation net income tax rate, would mean sharp increases in the taxes of the office equipment, food manufacturing and plant equipment industries, while decreases in the corporation tax would ensue for the paper manufacturing and the retail food trades.

The changing of the tax to a minimum alternative, by making the corporation liable for the higher of the two levies, would likewise have the same type of effect of redistributing the Corporation Business Tax burden among businesses within the State. The necessary increase in corporate tax rates that would be required to make up the lost revenues would fall most heavily on those businesses which now pay the largest portions of their Corporation Business Tax under the net income tax, and would fall least heavily, or would reduce the levies, on those industries that now pay the lowest portions of their Corporation Business Tax under the net income tax. We have seen no evidence to justify such a redistribution of the Corporation Business Tax burden among the corporate trades and industries in the State.

There is one other aspect of the problem that must be considered. We are making the recommendation elsewhere in this Report that a giant step be taken to reduce the heavy burden of property taxes in this State, including the property taxes paid by trade and industry. (See Part II.) The net worth tax component of the Corporation Business Tax is essentially a property tax on the privilege of doing business in corporate form, in that the levy is measured by the net value of the corporation's assets. With the broad-scale relief from property taxation being recommended, we do not believe that there is any justification for granting capital intensive corporate businesses still further relief from the property component of the Corporation Business Tax. The $52 million raised by the net worth component covered be used more equitably for the other purposes.

The Committee recommends:

The Corporation Business Tax should remain

TABLE 5-15

State of New Jersey

CORPORATE NET WORTH AND NET INCOME TAXES IN RELATION TO TOTAL TAX PAID

Sample of 40 Corporations, 1968

Industry Classification	Net Worth Tax in $ (% of Total)	Net Income Tax in $ (% of Total)	Total	Corporation Business Tax as a % of Allocated: Net Worth	Corporation Business Tax as a % of Allocated: Net Income
Apparel	61,035 (16.62%)	306,124 (83.38%)	367,159	1.20	5.10
Auto Mfg. and/or Parts Mfg.	176,291 (29.60%)	419,377 (70.40%)	595,668	.67	6.04
Chemical and/or Petroleum	617,708 (25.37%)	1,816,955 (74.63%)	2,434,663	.40	5.68
Electronics Mfg.					
Domestic	42,503	335,929	378,432	1.23	5.07
Foreign	143,811	394,622	538,433	.68	6.13
Total	186,314 (20.32%)	730,551 (79.68%)	916,865	.84	5.57
Food Mfg.					
Domestic	151,021	811,994	963,015	.48	5.54
Foreign	152,864	942,655	1,095,519	1.43	5.08
Total	303,885 (14.76%)	1,754,649 (85.24%)	2,058,534	.73	5.30
Food Retail					
Domestic	38,367	78,912	117,279	.61	6.32
Foreign	195,526	345,568	541,094	.55	6.66
Total	233,893 (35.53%)	424,480 (64.47%)	658,373	.56	6.59
Office Equipment	2,549 (9.92%)	23,145 (90.08%)	25,694	1.03	5.28
Paper Mfg.	54,113 (37.89%)	88,686 (62.11%)	142,799	.53	6.85
Pharmaceuticals					
Domestic	278,191	931,823	1,210,014	.48	5.91
Foreign	185,495	713,551	899,046	.42	5.73
Total	463,686 (21.99%)	1,645,374 (78.01%)	2,109,060	.45	5.83
Plant Equipment					
Domestic	20,416 (13.76%)	127,911 (86.24%)	148,327	.67	6.07
Miscellaneous					
Publishing, Restaurant, Rubber & Steel	62,226 (11.90%)	460,471 (88.10%)	522,697	.75	5.79
Construction	4,055 (22.38%)	14,062 (77.62%)	18,117	.89	5.49
TOTALS	2,186,171 (21.87%)	7,811,785 (78.13%)	9,997,956	.53	5.46
Foreign	1,655,673	5,525,216	7,180,889	.54	5.55
Domestic	530,498	2,286,569	2,817,067	.49	5.24

unchanged as a two-pronged levy on both net worth and net income. Proposals either to eliminate the net worth tax altogether, or to change the Corporation Business Tax to a levy on the greater of the net worth and the net income taxes, should be rejected.

Modifications in the Net Worth Base

The Committee also investigated the propriety of changing the New Jersey methods of computation of the corporate net worth base. One serious proposition would eliminate the long term debt as a deduction from gross assets in determining net worth. The committee concluded that the redistribution of the revenue would be so marked, industry by industry, taxpayer by taxpayer, the change was unwise.

Likewise, a second serious proposition, that of valuing a corporation's assets in the manner of neighboring Pennsylvania, was intensively studied.[16] The technique was that of taking into account three alternative methods of valuation of the corporation's assets:

1. The average selling price of the corporation's capital stock during the selling year.
2. Capitalization of earnings.
3. Actual value of assets.

The committee's wish to avoid additional technical complications at a time of large adjustments militates against extension or complication in the compution of the net worth base.

The Committee recommends:

No change in the determination of the net worth base

Modifications in Net Income Tax— Allowance of net operating loss deduction as a carryover or carryback.

The proposal has been made that, in determining the net income base, net operating losses be allowed as a deduction from gross income, as is permitted for Federal income tax purposes. The theory is that under a net income tax, equity requires that fluctuations in income, where a company suffers losses in some years, be used to offset profits earned in good years. For Federal income tax purposes, losses may be carried back three years and forward five years.[17] This means, of course, that taxpayers may in later years receive refunds, through the carryback loss provision, of taxes paid in earlier years.

While a number of States allow a deduction for net operating losses, under their corporate taxes measured by net income, including Indiana, Illinois and New York, many other States do not grant the deduction. In the latter category are California, Maryland, Massachusetts, Michigan and Pennsylvania.

The net operating loss deduction involves risks of fluctuation in revenues that are more dangerous for the States to take than for the Federal government, for the reasons already stated. If the provision should be adopted, in a poor year, with its revenues falling, the State will find itself obliged to make refunds of taxes received and spent in earlier years. And where refunds are not made for prior years, the carryover year's revenues will be reduced.

Moreover, the denial of the net operating loss is much less serious for corporations under the State tax, where the rate is at the proposed 7¼%, as compared with the 48% Federal corporate tax rate for larger businesses, and 26% for smaller corporate incomes. Moreover, it is to be observed that the State taxes are themselves deductible for Federal income tax purposes, so that the impact on the taxpayer of disallowing the net operating loss is reduced. Given the continuing needs of the State to support its institutions and its services in bad times as well as good—and indeed, the fact that some expenditures, such as welfare benefits, tend to rise when economic conditions worsen—our conclusion is that a net operating loss deduction should not be enacted.

Recommendation. The proposal to allow a carryover or carryback of net operating losses, in determining the net income tax under the Corporation Business Tax, should be rejected.

Apportionment and Allocation

New Jersey follows the principle of apportioning all income under its three-factor formula. No provision is made for specifically allocating any income, such as interest, dividends, capital gains, patents and copyrights, rentals, income from services, and the like, which is the practice in many States, Under the Uniform Division of Income for Tax Purposes Act (UDITPA), which has been adopted by 24 States and the District of Columbia, this type of income is taken out of the apportionment formula, and is specifically allocated.[18]

Consideration has been given to the question as to whether this State should adopt the UDITPA method of specifically allocating the receipts in question. Under the UDITPA technique, the net rentals from real or personal property located in the State, and net royalties from patents and copyrights used in the State (to the extent that these items constitute non-business income)

[16] Pa. Tax Reform Code of 1971, Sect. 601.

[17] Internal Revenue Code, Section 172.

[18] In several instances the State enactment does not conform entirely to the uniform law. The operative provisions of UDITPA are set forth in Article IV of the Multistate Compact, which is printed at Par. 6310, et seq., P-H State and Local Tax Serv., All States Unit.

are taxed entirely by the State of location or use (Sec. 4). Yet, management and other employees, working exclusively or principally in other States, may in fact be contributing to the earning of this income, in the management and leasing of the property, in financing its acquisition, in licensing the use of patents and copyrights, etc. Such States have a legitimate claim to tax part of the rentals and royalties derived from such activities carried on within their borders, which are entirely allocated to the State of location or use under UDITPA (Sec. 4).

The New Jersey rule, on the other hand, applies the apportionment formula to these items. For purposes of the receipts factor, rentals are allocated to the State in which the rented property is located, and royalties to the State in which the property is used. (Sec. 6(B)(5)). By this method, the State in which the real or tangible personal property is located will also increase its in-State allocation by the property factor, but the State in which employees manage the properties will benefit from the payroll factor. This appears to be a more equitable method of determining the respective States' shares of such income than by specific allocation.

The so-called Ad Hoc Committee has rejected the UDITPA general approach to specific allocation, and instead follows New Jersey's method of applying the three-factor formula to all items of income, except for dividends, which are allocated to the State of commercial domicile.[19]

The apportionment or allocation of dividends and interest is a more complicated problem. Many States specifically allocate all dividends and interest to the State of commercial domicil, presumably on the theory that since the financial affairs of the corporation are typically managed there, that State alone is entitled to tax. In New Jersey, only 50% of the dividends received from non-subsidiaries are included in the measure of the net income tax, and dividends from subsidiaries (at least 80% owned) are totally excluded from the tax base. (Sec. 54:10A-4-k(1)). Hence, we are concerned only with the allocation or apportionment of the 50% of non-subsidiary dividends that are taxed, and with the treatment of interest. Since such dividends and interest normally arise from the handling of working capital and from temporary investments in the course of regular business operations, we see no warrant for separating them out from the general formulary apportionment, which takes into account the overall activity, personnel and property of the enterprise.

Property factor: Valuation of rented property

In recent years, the leasing of property, both real estate and tangible personal property, has in effect become a technique for financing what in former times was the ownership of the property. Office buildings, department stores, industrial machinery, trucks, airplanes, computer equipment, and the like, are widely held by the user under lease, motivated by a variety of financing, tax and other reasons.[20] From an economic point of view, much of this leased real and personal property is tantamount to ownership by the lessee. In such cases, as well as the case in which a corporation occupies property under a traditional lease, there tends to be a distortion in the operation of the property factor under the apportionment formula, because leased property is not taken into account.

In order to eliminate the disparity in tax treatment between owned and leased property, a good many States include rented real estate and tangible personal property in the property factor of their apportionment formulas.[21] The lessee includes in the in-State numerator and the overall-denominator real estate and tangible personal property owned or leased to it; and rented property is usually treated as having a value equal to eight times the gross rents paid.[22] In the interest of equality of treatment of taxpayers and in order to equate these two types of property interests, we recommend the inclusion of leased property in the property factor.

Receipts factor: The throw-back rule

Under the statute, for purposes of determining the receipts fraction of the apportionment formula, receipts from sales of tangible personal property are allocated to this State only where shipments of the goods are made to points within the State (Sec. 6(B)(1) and (2)). Thus, the State uses the destination test of allo-

[19] The Ad Hoc Committee was formed in 1969 by a group of leading figures in State taxation, drawn from the States and large corporations, in an effort to develop a bill for submission to Congress, dealing with the major controversies in State taxation of interstate business, that might be acceptable to both State tax administrators and business organizations. The Co-Chairmen were George Kinnear, then Director of the Department of Revenue of the State of Washington and Chairman of the Multistate Tax Commission, and Leonard E. Kust, then Vice-President and General Tax Counsel of Westinghouse Electric Corporation. A summary of the provisions of the bill produced by the Ad Hoc Committee and their commentary on the bill are printed in P-H State and Local Tax Serv., All States Unit, Par. 6611; see Secs. 301, 307(b) of the bill.

[20] It has been estimated that, as of December 31, 1969, tangible personal property of the type of equipment and capital goods referred to in the text, there was approximately $30 billion without taking real estate into account, held under lease arrangements in the United States. See Leasing World.

[21] The States following this rule include California, Connecticut, Delaware, Maryland, Massachusetts and Michigan. See Prentice-Hall, State and Local Tax Serv., All States Unit, Par. 1048-A. New York is one of the comparatively few States which limits the inclusion of rented property in the property factor to real estate. Ibid.; New York Tax Law, Sec. 210-10, Franchise Tax Regs., Sec. 4.14, C.C.H., N.Y. Tax Serv., Par. 5-809-a.

[22] See Note 21, supra.

cation of receipts from the sale of goods, a test that has increasingly been adopted by the States over the country, and is embodied in UDITPA (Sec. 15). As a result of the operation of this rule, where goods are shipped to customers located in other States in which the corporation is not taxable, either because the Commerce Clause, or the Due Process Clause, or P.L. 86-272 prohibit the imposition of an income or franchise tax, the receipts from these sales in effect escape taxation by any State.

No good reason appears for this escape from tax. To avoid this result, UDITPA provides for the "throw-back" of such receipts to the State of origin, that is, the State from which the goods are shipped. Thus, under that rule, if a manufacturer based in New Jersey, ships goods to customers located in another State which lacks jurisdiction to impose a franchise or income tax, the receipts are included in the New Jersey numerator of the receipts factor (Sec. 16). This rule does not, however, apply where the destination State, having the power to impose a franchise or net income tax, chooses not to exercise that power, but only in circumstances in which that State cannot tax the receipt (Ibid.). This restriction of the throw-back rule was adopted, in part at least, because the customer's State, in a case where it possesses the power to tax the vendor, may impose taxes other than income-based or capital stock taxes on the out-of-state vendor. Given a case, however, where the destination State is without power, by reason of the United States Constitution or Congressional legislation, to impose the tax, it appears eminently reasonable that some State having the taxing power should take the receipts into account in levying an income-based or capital stock tax. The selection of the State of origin for this purpose appears both practical and equitable.

Accordingly, it is recommended that the throw-back rule be adopted by this State in the case of sales of goods shipped to other States, the District of Columbia and Puerto Rico.

The UDITPA provision has been criticized by some business spokesmen for going further and applying the throwback rule to shipments to foreign countries and to Puerto Rico and territories and possessions of the United States.[23] As for foreign countries, the throwback rule suffers from serious defects. The taxing powers of the States are determined by laws and the Constitution of the United States, and while there are many uncertainties as to how far the jurisdiction to tax interstate vendors extends, nevertheless, we do have a common, legal constitutional fabric from which to proceed. This becomes an unchartered sea, with widely different legal and constitutional standards and traditions from ours, and with enormous difficulty in determining the taxing jurisdiction of foreign countries. Consequently, it is believed that foreign sales should be excluded from the throw-back rule. Since Puerto Rico and the United States possessions and territories are governed by American law, it seems appropriate to apply the throw-back rule to such areas.

3. *Sales to the United States government.*

Sales to the Federal government do not typically involve the kind of solicitation, advertising and other activities that normally take place in the State to which the goods are shipped, where non-governmental selling is involved. When the Federal government purchases goods for use at army bases, for example, there is as likely as not to be little or no activity at the installations to which the goods will be shipped, or used. The major sales activity may take place in Washington, D.C., the goods may be stored in a warehouse for later shipment over the country, or in other parts of the world, as they may be required. Consequently, the reasons for the adoption of the destination test of receipts from sales in determining the sales factor are to a very considerable extent inapplicable to sales to the United States government. As a result, UDITPA provides for the allocation of receipts from such sales to the State of origin, in computing the sales factor of the apportionment formula.[24] This appears to us to be a sound rule, which should be embodied in our statute.

The Committee recommends:

The policy now reflected in the Corporation Business Tax of treating all items of income within the apportionment formula should be continued, and that proposals for specific allocation of items such as dividends, interest, capital gains, rentals, service income, and the like, should be rejected.

Leased real estate and tangible personal property should be included in the numerator and denominator

[23] This appears to be the effect of Section 16 and 1(h) of UDITPA, since the latter provision defines the term "State" as including "any foreign country or political subdivision thereof", as well as "the Commonwealth of Puerto Rico and any territory or possession of the United States". In the Regulations proposed by the Multistate Tax Commission, the draftsmen in dealing with this problem, have sought to construe the language of UDITPA as being governed by our State standards of testing taxing jurisdiction. The Proposed Regulations take the position that the determination of whether a foreign "State" has jurisdiction to impose a net income tax "shall be made as though the jurisdictional standards applicable to a state of the United States applied in that 'state' ". Prop. Reg. IV-3(c), P-H, State and Local Tax Serv., All States Unit, Par. 6155.

[24] Sec. 16(b). The Ad Hoc Committee bill treats sales to the United States government in the same way as other sales, as is done under the present New Jersey law, by allocating the receipts to the State of destination for purposes of the receipts factor. Sec. 304(b).

of the property factor of the apportionment formula of the Corporation Business Tax; and such property should be valued at eight times the gross rental.

The receipts factor of the apportionment formula should be modified by adopting the throw-back rule (to the State of origin), with respect to goods shipped to customers located in any other State, the District of Columbia or Puerto Rico, in circumstances in which the buyer's State does not have the power to impose an income or franchise tax on the vendor.

For purposes of the receipts factor also under the apportionment formula, sales of goods to the United States government should be allocated to the State of origin of the shipment.

Consolidated Returns

Formulary apportionment is a technique developed by the States for determining the portion of the measure of a tax attributable to the State, where the taxpayer's activities, assets and business are located in more than one State, or are in part outside the country. One of the most troublesome and controversial issues in State corporation taxation has been how to determine the State's share of the net income, or capital stock, or other tax measure of an enterprise conducted through affiliated corporations operating in various States and in foreign countries. This issue has taken on increasing importance as business has expanded and corporate pyramids have multiplied, and is now exacerbated by the growth of the corporate conglomerate.

The States sought to deal with affiliated groups of controlled corporations which siphoned off some income or other taxable base, through artificially fixed prices for goods or services and other intercompany arrangements, by enacting provisions for re-allocating income and deductions on an arm's length basis. This is the instrumentality employed by Section 482 of the Federal Internal Revenue Code for dealing with intercompany dealing among affiliated and related United States and foreign corporations. As experience developed and as businesses expanded, this type of tool proved inadequate to the task of determining the income attributable to a State in which a corporation was conducting an operating function of an integrated enterprise organized in a multicorporate structure. This was not merely because of the difficulties involved in determining reasonable arm's length prices, but for the more fundamental reason that separate accounting was increasingly regarded by State tax administrators, by its nature, as an unsatisfactory technique for determining the share of the income of a unitary business that ought to be attributed to the various States in which the business is conducted.[25] As a consequence, apportionment by formula began to be extended to multicorporate, unitary businesses, with the consolidated or combined return employed as the method of achieving this result.[26]

Ariz. Rev. Stat., Sec. 43135(e); Cal. Rev. and Tax Code Secs. 25104, 25105; Colo. Rev. Stat., Sec. 138-1-28; Conn. Gen. Stat., Secs. 12-221, 223; Del. Code tit. 30, Sec. 1906; Ga. Code, Sec. 92-3202; Reg. Sec. 92-3209; Iowa Reg. 22.37; Kans, Reg. 92-4-98; Ky. Rev. Stat., Secs. 141.205(1), (3); La. Rev. Stat., Sec. 47:95; Md. Code art. 81, Sec. 296; Minn. Stat., Sec. 290.34(2); Mont. Reg. 208; N.Y. Tax Law, Sec. 211.4; N.C. Gen. Stat., Sec. 105-143; N. Dak. Cent. Code, Sec. 57-38-14; Okla. Stat. tit. 68, Secs. 878(i), (j); Oreg. Rev. Stat., Sec. 317.360; S.C. Code, Secs. 65-285, 297; Utah Reg. 4; Vt. Reg. Arts. 600, 607; Va. Code, Secs. 58-136, 138, 139; Wis. Rev. Stat., Sec. 71.11(7)(b). (Vol. I, p. 246, note 217).

It then declares that, "of these, at least five States have provisions which appear broad enough to require or permit a combined report", Arizona, California, Georgia, Minnesota and New York, as to which it appears consolidation may be permitted or required without a showing of artificial pricing or other income distorting arrangements. Under the Wisconsin corporate tax, the Department of Taxation may require the filing of consolidated returns. Wisc. Stats., Sec. 71.11-7(b).

The unitary business doctrine has been recognized by the courts of this State under the Corporation Business Tax, as applied to a single corporation doing a multistate business.[27] However, in the absence of any explicit provision in the statute for consolidated reporting, the courts have upheld the Director's regulation that consolidated returns for a unitary enterprise, operating through affiliated corporations, are not permitted.[28]

If a consolidated return provision were to be acted, we would recommend that taxpayers be given the right to file consolidated returns, and that the Director of the Division of Taxation likewise have the power to require the filing of a consolidated return, provided, of course, the statutory standards prescribed for consolidation are met. We know of no justification for the use of a one-way street, i.e., as is true in some States, where the taxpayer has the privilege of filing a consolidated return, but such reporting may not be required by the taxing authority,[29] or vice versa.[30]

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[25] For the history of the development of formulary apportionment as applied to a single corporation doing business in more than one State, and its subsequent extension by some States to an affiliated or controlled group of corporations, see Hellerstein, State and Local Taxation: Cases and Materials, Ch. 8 (3rd ed. 1969).

[26] The Report of the Special Subcommittee on State Taxation of Interstate Commerce, Note 13, supra, enumerates 23 States "that have provisions authorizing their administrators to require or permit consolidated returns in order clearly to reflect income", citing:

[27] Household Finance Corp. v. Director, Division of Taxation, 36 N.J. 353, 177 A. 2d 738 (1962); F. W. Woolworth Co. v. Director, Division of Taxation, 45 N.J. 460, 213 A. 2d 1 (1965).

[28] United States Steel Corp. v. Director, Division of Taxation, 38 N.J. 533, 186 A. 2d 266 (1962).

[29] See Mass. Gen. Laws, ch. 63, Sec. 39.

[30] See the Wisconsin provision, Note 31, supra.

In the *Second Report* of the Commission on State Tax Policy made in 1947, consolidated returns were considered and rejected, on the ground that the effect would be only to reduce the taxes of New Jersey holding companies and their subsidiaries (pp. 96, et seq.). The 1947 Corporation Business Tax, however, was a very different levy from the present tax; that statute imposed only a net worth tax. A 50% deduction was allowed for investments in subsidiaries only to the extent of the subsidiary's New Jersey allocation percentage, whereas under the present statute, there are two types of deductions allowed for subsidiary capital: (a) 50% of the holding company's book investment in the subsidiary, regardless of whether the latter is taxable in New Jersey, plus (b) the continuation of the 1947 deduction of 50% of the subsidiary's New Jersey allocation percentage, applied to the book value of the investment. (Secs. 4(d) and 9).

In 1947, no income tax was imposed under the Corporation Business Tax. Under the present corporation net income tax, dividends from subsidiaries are already eliminated, so that their elimination as intercompany items in a consolidated return would have no tax effect (Sec. 4(k)). At the present time, the income of a holding company operating in New Jersey is taxed, as is the income of its subsidiaries, to the extent they do business in the State. The income of the other affiliates in the unitary business is not taken into account. But, under consolidating income reporting, the net income of the entire unitary enterprise, including companies not doing business in the State, would be taken into account under the apportionment formula in determining the portion of the income of the unitary business that should be attributed to New Jersey.

Consequently, the conclusion reached in the 1947 report that consolidated returns would result in a reduction of revenues may not be true today. No data are available from which a reasonably workable estimate can be made as to whether, to what extent, and in which industries, revenues would increase or decrease, as a result of the enactment of a consolidated return provision. Moreover, there are troublesome problems, and sharply conflicting approaches by State tax administrators and representatives of business as to how to define the elusive concept of a unitary business, the scope of an affiliated group to be included in a consolidated return, whether subsidiaries operating in foreign countries should be included, the treatment of intercompany dividends, and the like.[31] Legislation has been pending in Congress since 1964 for the adoption of a Federal statute, which would require the States to follow uniform Congressionally established standards and rules for consolidated returns.[32] The States have generally opposed this legislation, and efforts to reconcile the views of the various States and the larger businesses have been made, and are continuing, in the hope that acceptable solutions may be found which could be embodied in Federal or State legislation. While these efforts have thus far not achieved the wide concensus required to produce a viable solution acceptable to the interested parties, they are continuing.

Accordingly, in view of the importance of substantial uniformity of the laws and regulations of at least the major States in dealing with the unitary business and consolidated return issues, it is our conclusion that this State ought to await further action by the States or by Congress, hopefully growing out of the joint efforts of State tax administrators and representatives of business, to find mutually acceptable solutions, before modifying the present law in this area.

The Committee recommends:

The existing provisions of the Corporation Business Tax, which have been administered and interpreted as debarring the application of the unitary business doctrine to an enterprise consisting of separate, affiliated corporations and as precluding the filing of consolidated returns, should remain unchanged, pending further developments in this area designed to achieve a uniform treatment of these matters by the various States.

The Development of Appropriate Methods of Apportionment for Special Industries Covered by the Corporation Business Tax

The Corporation Business Tax applies the general three factor property—payroll—receipts apportionment formula to the whole spectrum of businesses subject to the levy, which maintain regular places of business outside the State (Section 10A-6), except for the special provisions applicable to investment companies.[33] The "Massachusetts formula" employed by the Corporation Business Tax was developed in the light of the needs of interstate manufacturing, process-

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[31] For an analysis of the conflicting approaches to the unitary business doctrine and consolidated returns, see Hellerstein, "Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business", 21 National Tax Journal (1968); and Rudolph, "State Taxation of Interstate business: The Unitary Business Concept and Affiliated Corporate Groups", 25 Tax Law Review 171 (1970).

[32] These provisions are included in bills pending before Congress referred to in Note 13, supra.

[33] This tax does not apply to public utilities, banks or other financial institutions, insurance companies and other corporations taxed by other statutes, as to which distinct methods of apportionment and allocation have been developed.

ing and selling industries.[34] As is true in this State, railroads, pipelines, electric and gas utilities, insurance companies and financial businesses were generally excluded from the three factor formula, but as other businesses have developed which have characteristics that are difficult to fit into the general formula, the States have been slow to devise new apportionment methods to suit their needs. It is the view of this Committee that there is a need for an overall review of the applicability and impact of the general apportionment formula to a number of specialized businesses, with a view toward the adoption of apportionment methods that would be more appropriate to these businesses. We here enumerate selected industries which the Committee believes require special treatment, as illustrative of our recommendation.

There is, of course, the provision of Section 10A-8 of the statute, which provides for adjustment by the Director of the apportionment formula, where its application does not properly reflect the activity, business, receipts, capital, entire net worth or entire net income of a taxpayer, reasonably attributable to the State. In such a case, the Director may apply "any other similar or different method calculated to effect a fair and proper allocation of the entire net income and the entire net worth reasonably attributable to the State". This provision, however, has been used very sparingly and has not resulted in the promulgation of specialized formulas for particular industries. In the rare cases in which it has been used, the discretionary provision has been applied to a specific case of hardship or inequity. While this use of the discretionary apportionment is entirely appropriate, we believe that what is needed is the development and promulgation of apportionment formulas and methods of allocation suited to the particular needs of the specialized industries.

Truckers and Airlines. The general formula appears to us to be unsuited to the apportionment of the tax bases of truckers and airlines. In practice, the Division of Taxation has applied the general formula to truckers and airlines and has utilized the methods developed under the property tax for determining the value of trucks, airplanes and other rolling stock to be attributed to the state.

The method employed by the State under the property tax for determining the amount of property employed in the State by truckers and airlines, has grown out of the extensive experience of New Jersey and other States over the decades with property taxation of railroads, express companies and other transportation companies. These techniques have moved from crude mileage allocations to more sophisticated methods, such as ton miles of freight, passenger miles and the like.[35] With respect to airlines, consideration has also increasingly been given to factors such as ground time spent in airports, along with passenger miles, plane ton miles and the percentage of flight miles within the State.[36]

All this, however, relates solely to the property factor. There is still the problem of payroll and receipts, as to which the general formula is hardly suited. Thus, in practice, in the case of airlines, the Director has allocated to the State the entire receipts from tickets sold in New Jersey and freight contracted for in New Jersey, and has excluded the entire receipts from passenger tickets purchased outside the State and the receipts from freight contracted for out of the State. The receipts of truckers have likewise been allocated by the place in which they were contracted for. The payroll of airplane pilots and truck drivers has been attributed to the particular office to which the pilot or driver was attached. These are rather crude methods and may work out inequitably, in some cases to the disadvantage of the taxpayer and in others to the disadvantage of the State. We recommend that the Director make a study of how the formula has worked out in practice, and attempt to evaluate the effects of alternative methods that might be considered.

In Pennsylvania, there is a statutory provision for apportioning the income of railroads, trucks, buses and airline companies under which the apportionment is made on a revenue mileage basis.[37] It is essentially a one factor formula, in which the revenue miles (a revenue mile is defined to mean "the amount of receipts derived from the transportation of persons or property one mile") within and without the State determine the apportionment. Non-business income of these companies is allocated in accordance with a formula ap-

[34] The current three factor formula is the result of the efforts of the National Tax Association, beginning in 1920 to develop uniform apportionment and allocation methods among the States. See "Model Business Income Tax" VI N.T.A. Bull. 113 (Nov. 1920). In 1939, the Committee on Allocations of the N.T.A., in reporting on a survey of tax apportionment methods used throughout the country, declared that 10 of 32 income taxing states used the three factor property-payroll-sales formula and went on to point out: "It is obvious, however, from studies conducted by the present Committee that such a formula would not be suitable to taxpayers other than those engaged in manufacturing or conducting mercantile business" (1939 N.T.A. Procs. 190, 204-205).

[35] For a review and critical analysis of the methods used in the taxation of transportation companies, including airlines, see Wilkie, "Income Apportionment of Unitary Public Utility Corporations", 15 Tax Law Review 467 (1960).

[36] Ibid. The Committee on Taxation of Airlines of the National Association of Airlines is making a survey and study of apportionment as applied to airlines, Mr. Sidney Glaser, Director of the Division of Taxation of New Jersey is the Chairman of the Committee.

[37] Pa. Tax Reform Code of 1971, Sec. 401-2(b).

plicable to general businesses.[38] In the related areas of pipeline and natural gas companies, Pennsylvania has adopted a somewhat similar method of apportioning business income by reference to revenue ton miles, revenue barrel miles or revenue cubic feet miles.[39] Again, general non-business income outside the pipeline operations is subject to the general business formula of the State.

We refer to the Pennsylvania method not for the purpose of recommending that it be adopted, but simply by way of suggesting that some other States have developed other techniques and these ought to be considered in the review here proposed of the apportioning methods applicable to such businesses. Indeed, the Pennsylvania method appears to us open to question; perhaps it might be used as one factor along with a payroll factor developed to take into account office, executive and terminal payroll.

Radio and Television. Radio and television stations are likewise, to the extent that they are taxed, covered by the Corporation Business Tax and the general apportionment formula is applied to them. Because the New Jersey tax is a franchise tax and the Supreme Court has held that such a tax may not be imposed on the conduct of a radio station whose broadcasts are interstate, New Jersey has not sought to tax New York City stations, such as CBS and NBC, and Philadelphia stations.[40]

Under the second tier direct net income tax here proposed, however, it may be that such out-of-state broadcasters and telecasters are within the constitutional tax reach of this State. This is an unresolved constitutional issue, because the States have not sought to devise methods of taxing this new industry that may perhaps overcome the constitutional barriers to the traditional franchise tax.[41]

A close look at the actual operations of the industry may reveal that the broadcasters and telecasters engage in ancillary activities in the State, such as the solicitation of advertising, periodic production of mobile telecasts, the handling of film distribution, the use of local representatives or agents, and the like, which may strengthen the State's jurisdiction to tax. In addition, network contracts and the relations and activities of the networks with New Jersey affiliated stations may justify the levy of an income tax by this State, on a portion of the income of the networks derived from the local stations. As a matter of fiscal policy, there is no good reason why television and radio stations, based in the bordering States, that transmit their electronic product into New Jersey, and derive substantial advertising revenues from the State's market, should not contribute to the cost of operating the government of this State.

If an effort is to be made to tax the income of out-of-state radio and television companies, the application of the general apportionment formula would probably produce little or no tax, even if the levy should be sustained. The property and payroll would be largely, if not entirely, attributed to other States; and the receipts factor, geared to sales of tangible property, is not adapted to television and radio stations, with a consequence that probably little or no receipts allocation would be made to this State. In lieu of the receipts allocation contained in the general formula, a more realistic and more economically justifiably technique might be the allocation of receipts by reference to the listening audience. It is our understanding that this is the way television and radio time charges are determined, so that receipts allocation by reference to the advertising market would respond to the economic realities of the business.

On the other side of the coin, to the extent that radio and television stations that are based in New Jersey pay to this State virtually 100% of their tax bases, they would appear to be paying a disproportionately large amount of their tax base and should be entitled to relief, if they are taxable by the States of the markets they reach. In short, we recommend that a serious review be made of the entire problem of taxation of the radio-TV industry, and of the development of methods of apportionment which fit the particular characteristics of the industry.

Investment Companies. Likewise, the general formula does not appear to us to use factors that ought to be considered in determining the income of investment companies attributable to the State. Since only real property and tangible personal property are taken into account under the property factor, a mutual fund that has its only offices in New York City will probably have a zero property factor in this State, although it may have many stockholders located in this State. Its payroll may be entirely allocated to the New York office, although in fact it may have (directly or through a selling affiliate) many New Jersey agents or representatives soliciting sales of the investment company stocks, to New Jersey residents, often as part-time agents working out of their homes. Similarly, the investment com-

38 Ibid.

39 Idem, Sec. 401-2(c).

40 Fishers Blend Station, Inc. v. State Tax Commission, 297 U.S. 650 (1956).

41 For other cases and a commentary dealing with the taxation of radio and television companies, see Albuquerque Broadcasting Co. v. Board of Revenue, 51 N.M. 332, 184 P.2d 416 (1947); McCaw v. Fase, 216 F.2d 700 (9th Cir., 1954), certiorari denied, 348 U.S. 927 (1955); Pacific Broadcasting Co. v. Riddel, 427 F.2d 519 (9th Cir., 1970); Ruehlmann, "State Taxation of Radio and Television", 20 U. of Cincinnati Law Review 19 (1951).

pany's receipts, which are largely dividends, interest and capital gains, will be likewise allocated outside the State. Consequently, the State collects little or no taxes from out of State taxed investment companies that may have a substantial market in New Jersey for their major product—their own stock.

The statute provides that regulated investment companies may pay tax on only 4% of their entire unapportioned net income and 15% of net worth (Sec. 54:10A-5). This provision was presumably designed to relieve disproportionate apportionment to the State in the case of New Jersey headquartered regulated investment companies. All or most of their net income and net worth would otherwise be allocable to New Jersey. But the statute leaves the out-of-state based investment company virtually untaxed.

To be sure, there are both constitutional and policy questions as to the way in which out-of-state investment companies may and should be taxed. It is our view that, as a matter of policy, the exploitation of the market in New Jersey for stock in investment companies warrants the imposition of some duty to contribute to the State's needs, and while the matter has not been tested in the Supreme Court, we believe that a persuasive case can be made out for the view that an out-of-state based investment company, which regularly sells its stock in a State through employees or agents operating within the State, may be constitutionally subjected to an income tax that is fairly apportioned to the State.[42]

Some other States have sought to adapt their apportionment and allocation methods to the particular characteristics of investment companies. Thus, Pennsylvania applies its corporate net income tax to regulated investment companies doing business in other States by the use of a two-part single factor gross receipts formula,[43] consisting of:

> *Numerator:* gross receipts from
>
> (a) sales by the corporation of its own shares of stock to Pennsylvania investors, plus
>
> (b) sales by the corporation of its portfolio securities, where orders are placed with or credited to offices of registered security dealers in Pennsylvania.
>
> *Denominator:* total gross receipts from sales by the corporation of its own stocks and portfolio shares.

There is a good deal of merit to the Pennsylvania formula in weighting sales of the investment company's own stock in the formula, since that activity is a substantial part of the business of regulated and other publicly held investment companies. However, the office of the broker selling portfolio securities appears to us to have little bearing on how the tax base should be allocated. Indeed, this factor may tend to encourage uneconomic manipulation of the sales orders. Conceivably, a two-factor formula consisting of (a) payroll, and (b) receipts from sales of the corporation's own securities located in the State over all such receipts, might produce a more equitable result.

The foregoing are examples of substantial enterprises with respect to which it is believed reconsideration of the general apportionment formula is desirable, particularly if our recommendation as to a second tier income tax should be adopted. Doubtless there are others that will be disclosed by investigation. Accordingly, it is our recommendation that a study be undertaken to review the operation in practice of the general apportionment formula of the Corporation Business Tax as it is applied to specialized industries.

The Committee recommends:

The Standing Committee on Tax Legislation, whose establishment is proposed in Section E of this Report, review the existing apportionment formula and practices, as applied to specialized industries; that it analyze the amount of revenues collected from such industries; and devise and recommend, where appropriate, the enactment of legislation or the promulgation of regulations of apportionment and allocation methods, which will more fairly reflect the activities, income and net worth, of such industries attributable to the State.

Adoption of a Notice of Business Activities Requirement as a Disclosure and Tax Enforcement Device

New Jersey has on its books a statute requiring a foreign corporation to obtain a certificate of authority from the Secretary of State before doing business in the State. The sanctions provided for failure to qualify are small fines, together with a provision that: "No foreign corporation transacting business in this State without a certificate of authority shall maintain any action or proceeding in any court of this State, until it shall have obtained a certificate of authority.[44] The statute explicitly provides that the validity of contracts is not to be impaired by the failure of the foreign corporation to qualify, and shall not prevent its defending any action or proceeding.[45]

Similar statutes are in force in all the States but the sanctions vary. Some follow the New Jersey pattern, whereas others impose fines and personal liability on

[42] See the discussion above of the constitutionality of direct net income taxes levied on foreign corporations that may not be "doing business" in the taxing State.

[43] Pennsylvania Tax Reform Code, 1971 Sec. 401(3)-3, 72 Purdon's Stats. 3420 (a). This provision was first enacted in 1964.

[44] N.J. Stats., Sec. 14A-13-4. The fines that may be imposed range from $200 to $1,000 per year. Ibid.

[45] Ibid.

corporate officers and agents for the debts of the corporation. Moreover, in a few States, contracts made before a required qualification are void with respect to the obligations of the other parties.[46] However, in most States, as in New Jersey, the court action of the delinquent foreign corporation is merely suspended until such time as it qualifies, with the consequence that there is no great compulsion on foreign corporations to qualify, at least where there is doubt or uncertainty as to their duty to do so. Since the statute thus provides an escape hatch, such sanctions have proved largely ineffective; fines on the corporation and personal liability imposed on corporate officers have seldom been enforced.[47]

We have recommended in this Report that the State adopt a second tier net income tax in order to impose tax on foreign corporations, not qualified and not "doing business" here in the traditional franchise tax sense but, nevertheless, deriving income from sources in the State and having adequate Due Process nexus with New Jersey to give the State jurisdiction to tax (limited by the restrictions of PL 86-272). Such corporations, of course, are not subject to the qualification requirement or their sanctions.

We believe that it is important, in order to safeguard the State's revenues and reduce unfair tax-free competition with businesses that pay taxes to this State, that the Legislature adopt a more effective technique for discovering foreign corporations that may be taxable, but that are now paying no taxes, and would otherwise escape the broadened jurisdiction of the proposed second tier tax. To seek to accomplish that objective, we propose that a statutory provision be adopted requiring certain non-qualified foreign corporations to file with the Division of Taxation a Notice of Business Activities. The broad outlines of this proposal follow:[48]

1. Every foreign corporation subject to the Corporation Business Tax ("CBT") or the Corporation Income Tax "CIT", the term here used to refer to the proposed second tier tax) which, during its last preceding fiscal year, carried on any of the activities or maintains any of the property described by the statute, which is not exempted from the filing duty (see Par. 2, below), will be required to file a Notice of Business Activities.

2. Exemption from the duty to file the Notice will be provided for any foreign corporation which:

(a) By the end of its fiscal period for the preceding fiscal year had received a certificate of authority to do business in the State; or

(b) Files a timely return under the CBT or CIT for such fiscal year.

The Notice would be required to be filed in the office of the Director of Taxation by the date on which the CBT and CIT returns are required to be filed by corporations subject to these taxes.

In prescribing the form of the Notice, the statute would declare that it will contain a provision in which the foreign corporation may disclaim liability for the CBT and the CIT, and of any obligation to obtain a certificate of authority to do business in the State.

3. The activities or property maintenance in the State which would give rise to the duty to file the Notice of Business Activities, as they would be enumerated in the statute, would embrace the maintenance in the State of an office or other place of business (such as warehouses and terminals); employees, agents or representatives, including independent contractors. The presence during the fiscal period of employees, agents or independent contractors in connection with the corporation's business, even though not regularly stationed in the State, would be included within the duty to report the maintenance of personnel in the State.

With respect to the ownership or maintenance of property in the State, the provision would cover not only real and tangible personal property, directly used by the foreign corporation in the state but also its property, tangible and intangible, here employed by

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[46] For a summary and review of the statutes in force over the country, and their enforcement, see Note, "Sanctions for Failure to Qualify with Corporate Qualification Statutes: An Evaluation", 63 Columbia Law Review 116 (1963). See, also, 18 Fletcher, Cyclopedia of Corporations, Sec. 8609 (1955); Hornstein, Corporation Law and Practice, Secs. 290-292 (1959).

[47] A survey, made by the editors of the Columbia Law Review of the registration statutes, the sanctions and their enforcement, through letters to the Attorney General of each of the States, concludes:

"In most states the provisions are largely unenforced; indeed, in the survey, only seven of the thirty-six responding states indicated anything resembling active enforcement. Non-enforcement is due in large part to the failure to discover offending corporations, both because of a lack of personnel with which to police the provision and because of the difficulty involved in determining when a corporation is transacting local business. Even when the statutory scheme is enforced against corporations, prosecution is almost never brought against individuals, perhaps in recognition of the inequity and ineffectiveness of such sanctions.

"Although some states do express a willingness to proceed upon discovery of a violation, general lack of prosecution mitigates the actual effect of both individual and corporate fines."

Note, "Sanctions for Failure to Qualify with Corporate Qualification Statutes: An Evaluation", Note 46, supra.

[48] The New York franchise tax law requires foreign corporations having an officer, agent or representative within the State to file an "Activities Report of Foreign Corporations Disclaiming Tax Liability", if the corporation does not file a franchise tax return. See N. Y. Tax Law, Sec. 211.1; Form CT-245, CCH N. Y. Tax Service, Par. 6-415. The form calls for information as to whether the corporation owned or leased real or tangible personal property or maintained merchandise or employed other assets in the State; and as to whether the corporation performed any construction, erection, installation, repair work, or other services in the State. The only penalty imposed for failure to file the report is a fine on the corporation, N. Y. Tax Law, Sec. 217-1.

others, such as leased equipment, licensed patents, trademarks, trade names and franchised businesses.

It would also appear desirable, in order to establish a simple, objective quantitative test for the filing of the Notice to require any foreign corporation that receives payments from persons residing in the State, or businesses located in the State, aggregating a minimum dollar amount to be designated by the statute, to file the Notice, regardless of any other connections with the State.

Finally, we recommend that there be a provision giving the Director of the Division of Taxation authority to designate other activities or property in, or interrelationships with, the State, which would give rise to the duty to file the Notice.

4. The sanction for failure to file a timely Notice of Business Activity with respect to any fiscal period would be a denial of access to the State and Federal courts in New Jersey, but only upon a determination by the court hearing the proceeding in which the issue is raised that the foreign corporation was required to file a return under the CBT or the CIT.[49] This is proposed because the sanction is deliberately designed to impose sufficient pressure to require the Notice to be filed in cases where there may be legitimate difference of opinion as to the corporation's taxability under the CBT or the CIT, so that the Division of Taxation can investigate and determine the issue for itself. In these circumstances, the penalty ought to be imposed only where the corporation is finally found to have defaulted in its statutory duty to file the tax return.

The denial of access to the courts could be limited to contracts executed and torts or other causes of action that arose during the fiscal period for which a Notice was due and was not filed on time; or the sanction could go further and deny the use of the courts in New Jersey for all contracts executed and all causes of action that arose at any time prior to the end of the last fiscal period for which the corporation failed to file a required timely Notice.

It is essential, however, to the effectiveness of the sanction that a late filing of the Notice will not restore access to the courts. There ought not be an automatic, statutory escape hatch, such as there is in the present law, where frequently it is a cheap risk for the corporation not to qualify, knowing that if the issue should arise in any case, it can always qualify nunc pro tunc.

Nevertheless, in order to eliminate hardship cases, such as those in which corporations that are ignorant of the duty to file the Notice might be penalized, it is recommended that the court in which the issues arise be granted power to excuse the failure to file, and restore the right of access to the courts. Such a power might be exercisable where the court finds that the corporation has sustained the burden of establishing the following conditions:

(a) The failure to file a timely Notice was done in ignorance of the requirement to file, and such ignorance was reasonable in all the circumstances; and

(b) All taxes, interest and civil penalties due the State for all periods be paid, or be provided for by adequate security or bond, before the suit may proceed.

No penal or criminal sanction is proposed with respect to this enforcement device, for the reason that such penalties might possibly raise some question as to the constitutionality of the Notice requirement under the Self Incrimination Clause of the Fifth Amendment. Compare Marchetti v. United States, 390 U.S. 39 (1968); Grosso v. United States, 390 U.S. 62 (1968).

The Notice procedure recommended will not, in our opinion, accomplish its purposes unless it is accompanied by a regular, systematic, follow-up and investigation by the Division of Taxation of Notices disclaiming taxability, at least where there is a possible basis for belief that the corporation may be taxable. Without effective enforcement, the provision is likely to become a dead letter.

The Committee recommends:

A statute should be enacted requiring the filing of a Notice of Business Activities by foreign corporations, whenever the corporation does not file returns under the Corporation Business Tax or the proposed second tier Corporation Income Tax, but which carry on specified activities, or maintain specified types of property, within the State. This Notice requirement, coupled with appropriate sanctions, is designed to strengthen the enforcement of the State's corporation tax laws.

[49] It appears preferable to tie in the sanction with the duty to file the return, instead of an obligation to pay a tax, for the year, so as not to involve the court in a determination of whether any tax was due in a year in which the corporation may, for example, contend it suffered a net loss.

Chapter V

Business Personal Property Replacement Taxes

The New Jersey Gross Receipts Tax on Unincorporated Businesses

This levy is an excise tax of ¼ of 1% on the gross receipts of individuals and other unincorporated entities engaged in business (N.J. Stats. Ann., Sec. 54; 11 B-1, et seq.). The act exempts businesses with yearly gross receipts of less than $5,000, as well as corporations subject to the Corporation Business Tax and the Financial Business Tax. The proceeds are paid to the State Treasurer for distribution to the municipalities as part of the personal property tax replacement revenue.

The tax was enacted in 1966 as part of the Business Personalty Replacement Program. Its yield has been as follows:

1971	17,098,182
1970	16,695,230
1969	16,074,007
1968	14,861,494

A tax measured by gross receipts suffers from several basic defects. It is imposed without reference to whether a business is making profit or losing money. It has no relationship to the value of the property used in the business. It is inequitable because it imposes heavy burdens on trades and businesses whose ratio of net profit to gross receipts is low, whereas high profit ratio businesses pay much smaller taxes. As stated in the 1966 Report on Financing Government in New York City, in discussing the New York City gross receipts taxes:

> "Gross receipts are high relative to almost any other economic measure—value added, payrolls, profits, invested capital—for goods-handling activities, in which firms make substantial purchases of goods and materials from other firms. For manufacturers, retailers and wholesalers, value added, payrolls and profits are all far smaller shares than they are, for example, for financial institutions or service establishments. Thus, compared to any conceivable alternative, gross receipts taxes are very burdensome for manufacturing and goods distributing businesses."[1]

[1]Final Research Report of the Graduate School of Public Administration, New York University, to the Temporary Commission on City Finances, City of New York, p. 67 (1966).

In 1966, the City of New York motivated, at least in part, by these objections to gross receipts taxes, terminated the General Business and Financial Business Taxes, which were measured by gross receipts or gross income, and substituted a General Corporation Tax, which is measured by net income or the value of capital stock, and an Unincorporated Business Tax, which is measured by net income.

The New Jersey unincorporated business tax on gross receipts was enacted as a temporary expedient, in the light of the need to replace revenues lost from the reductions in the Business Personal Property Tax. We are now reviewing the entire business tax structure of the State and are recommending far-reaching changes and tax reforms, which are designed to raise the revenues that the State and local governments require. We find no justification for the continuation of the gross receipts tax measure of the present unincorporated business tax, given its inherent weaknesses and inequities. However, it may be that a tax on unincorporated business is an appropriate and desirable fiscal measure for this State, if a more acceptable tax base than gross receipts is used.

We turn to a consideration of the unincorporated business taxes, measured by net income, that are used in three taxing jurisdictions in this country.

Net Income Taxes on Unincorporated Businesses

Most States impose taxes on the privilege of doing business in corporate form, but not otherwise. The tax typically also applies to so-called Massachusetts or business trusts, which are treated as corporations for tax purposes.

In 1937, the State of New York first enacted its tax on the conduct of business as an unincorporated association, which was imposed on the income of individuals, partnerships, syndicates, joint ventures and other forms of unincorporated businesses. This levy was imposed on unincorporated business, in addition to the State's personal income tax. The result is that in New York, both incorporated and unincorporated businesses are taxed on the income of the enterprise; the stockholders of corporations are taxed on their dividends, and the proprietors of unincorporated businesses on their distributive shares of the income. In 1966, when the City of New York first enacted its General Corporation Tax, it adopted a tax on unincorporated businesses closely modelled after the New York State levy.

The District of Columbia is the only other taxing jurisdiction in this country that imposes a tax on unincorporated businesses, measured by net income.

In considering the question as to whether New Jersey should enact a tax on unincorporated businesses, the historical background and the justification for singling out corporations alone for the imposition of a doing business tax are relevant. Prior to the great expansion of the corporate form of doing business in the latter part of the Nineteenth and the early part of the Twentieth Century, corporate charters were granted by the State Legislature. They were, indeed, special privileges or franchises granted to enable the corporation to build a canal, a turnpike, a railroad, develop an express line, or other business of interest to the State. In this context, the franchise to conduct business in corporate form seemed an entirely appropriate subject of taxation, while other forms of doing business remained untaxed. The modern corporation statute, under which all that groups of people typically require to obtain a corporate charter is a form-book certificate of incorporation, a filing fee and a clerk's stamp, has swept away much of the historical-special privilege basis for singling out corporations for tax.

There are other justifications, however, which have been offered to support taxes on the conduct of businesses in corporate form alone. Corporations enjoy the highly advantageous perquisite of limited liability; the owner-stockholders typically risk only their investment in the capital stock, and are shielded from personal liability for the corporation's debts. And their shares of stock are readily transferable in the market. It is these characteristics of corporations that have made them the great vehicles they have become for amassing large aggregates of investment funds. Moreover, as a result of the vast expansion of corporations, accelerated by mergers and more recently the emergence of conglomerates, all facilitated by the versatility of the corporate form, corporations dominate commerce and industry. As a consequence, it is argued that a special tax on corporations is also desirable because, at least in a broad sense, such a levy is in consonance with the ability to pay principle, in that a tax on corporations is a tax on the wealthiest segment of our business economy, and the recipient of most of the income generated by commerce and industry.

These arguments in favor of special doing business taxes on corporations alone are open to a number of questions. Limited liability and the capacity to raise large amounts of capital, and rather free transferability of interests, have been achieved in banking, brokerage, real estate, and more recently in leasing arrangements, through limited partnerships and trusts. Furthermore, while it is undoubtedly true that a large part of American industry is owned by a comparatively small number of gargantuan corporate enterprises, there are, nevertheless, highly profitable large and medium-sized businesses, conducted as partnerships and individual proprietorships. It is also to be observed that to the extent we are concerned with tax burden, we must look through the corporation to its stockholders, who in the final analysis bear at least part of the corporation tax on income. Admittedly, corporate stock ownership is concentrated in the higher income levels of our population; nevertheless, it is also true that there are millions of persons of modest incomes who own stocks, or are the beneficiaries of stocks held for them by mutual funds, pension plans and the like. And on the other hand, there are a large number of proprietors of individual businesses, partnerships who are persons of means and derive substantial income from their businesses.

We conclude that the historical reasons for singling out corporations for special doing business taxes no longer obtain, particularly, as corporation taxes are being broadened in their scope from the traditional franchise tax to a levy on an income derived from sources within the State (See the discussion of the proposed second tier net income tax in Chapter 4, supra). Nor are we convinced that the advantages of operating in corporate form are relevant to the selection of the proper subjects of business taxation. If the adoption of an unincorporated business tax should commend itself on the merits, there are less crude and more refined methods of giving preferential tax treatment to small and weak businesses than the rough and ready line now drawn, of taxing corporations as entities while non-taxing individual proprietorships, partnerships and other unincorporated businesses.

We turn to an examination of the major features of the New York State, the New York City and the District of Columbia taxes on uincorporated businesses.

Imposition and rates. The New York State tax is imposed "on the unincorporated business taxable income of every unincorporated business wholly or partly carried on" in the State. (N.Y. Tax Law, Sec. 701(a)). The rate until 1972 was 5½% of taxable income, as compared with the 7% corporate franchise tax rate; the latter was raised to 9% beginning in 1972, but the unincorporated business tax rate remained unchanged.

The New York City uincorporated business tax is modelled after the State tax, confined, however, to the territorial limits of the City (N.Y.C. Administrative

Code, Sec. S 46.1 et seq.). The rate is 4%, as compared with the General Corporation Tax rate of 6-7/10%, applied to taxable income allocated to the City. (Idem, Sec. R 46.1 et seq.).

The District of Columbia tax follows the general New York State pattern, but applies the same rate, 6% of taxable income allocated to the District, to both unincorporated businesses and corporations (D.C. Code, Secs. 47-1571a and 47-1574b).

Definition of unincorporated business. Under the statutes of all three jurisdictions, the measure of the tax is restricted to business income. That term is defined so as to exclude compensation received as an employee, income from investments, including the purchase and sale of stock for one's own account or for the account of the proprietors of a partnership or other unincorporated business, and income from the ownership, leasing, operation and management of real estate by an individual owner or an unincorporated business for their own account, are not within the coverage of the tax. (N.Y. Tax Law, Sec. 703(b); D.C. Code, Sec. 47-1574).

When we come to the professions and personal service enterprises, the levies of the three taxing jurisdictions reveal significant differences. The New York State statute excludes the following professions from the levy (N. Y. Tax Law, Sec. 703):

1. The practices of law, medicine, dentistry and architecture are given blanket exemptions.

2. The practice of "any other profession" is exempt only if capital is not a material income producing factor, and more than 80% of the gross income realized during the year is derived from personal services rendered by the proprietors.

New York City had utilized the same exclusions as the State prior to 1971, but in that year the exclusion of professionals from the unincorporated business tax was repealed. As a consequence the current law includes "profession" within the definition of unincorporated business, so that beginning with the year 1971, lawyers, doctors, architects and all other professionals are taxable as unincorporated associations. (N.Y.C. Administrative Code, S 46-2.0).

The District of Columbia has granted the most sweeping exclusions of the three levies, for it not only excludes the traditional professions from taxable unincorporated businesses, but also all service enterprises in which capital is not a material income producing factor. There are excluded from the definition of "unincorporated business" (D.C. Code, Sec. 47-1574):

1. Any "trade or business which by law, customs or ethics cannot be incorporated"; and

2. Any other trade or business in which over 80% of the gross income is derived from the service of proprietors, in which capital is not a material income producing factor.

Measure of the tax and allocation. The three jurisdictions essentially follow the Federal pattern in determining gross income and allowance deductions, restricted, however, to the type of income and related deductions attributable to unincorporated business income, as set out above. (See N.Y. Tax Law, Secs. 705-706). Thus, a decorator would report his gross income from his decorating business and deduct the expenses related to the business, but not the income or deductions growing out of his ownership and operation of an apartment house.

Under all three taxes, the taxpayer may apportion or allocate its taxable income, where the business is conducted within and without the jurisdiction, and a place of business maintained outside the jurisdiction. The New York State and New York City statutes provide for the use of separate accounting method to determine the income allocable to New York State or New York City, if the tax commission finds that the taxpayer's books fairly reflect the income derived from the State or City. (New York Tax Law, Sec. 707). If the books do not contain the requisite data, the three factor property-payroll-receipts factor is used.

The Regulations issued under the District Tax, on the other hand, call for the use of the UDITPA apportionment and allocation methods to determine the income apportionable to the District (D.C. Code, Sec. 14-1580.a and Regulations; see Chapter 4, supra, for a description of the UDITPA).

Exemptions, proprietors' allowances and credit. No allowance is made for personal exemptions or dependents under any of the three taxes. Instead, all allow a flat exemption of $5,000, which is not reduced where the income is allocated within and without the jurisdiction (N.Y. Tax Law, Sec. 709; D.C. Code, Sec. 14-1574c).

Nor do the unincorporated business taxes permit a deduction for salaries paid to proprietors; they substitute a "proprietor's allowance". Under the New York State and City statutes, there is a maximum of $5,000 per proprietor allowed for salaries payable to proprietors actively engaged in the business, but the total allowance to proprietors may not exceed 20% of the taxable income of the business (computed before the allowance). (N.Y. Tax Law, Sec. 708; N.Y.C. Administrative Code, S 46-8.0). The District of Columbia contains only the overall limitation of proprietor's allowances to 20% of the unincorporated business taxable income for salaries payable to active proprietors. (D.C. Code, Sec. 14-1557(b)(15)).

Finally, the two New York but not the District of Columbia levies, have adopted a credit against the tax, applicable essentially to small businesses. If the tax does not exceed $100, a credit is allowed for the full tax. If the tax is more than $100 but less than $200, there is a credit for the amount by which the tax is less than $200. (N.Y. Tax Law, Sec. 701; N.Y.C. Administrative Code, Sec. S 46-3.0). Thus, if the tentative tax is $175, the credit is $25, and the final tax is $150, but if the tentative tax is $200, that becomes the final tax.

There are, of course, other provisions that would have to be considered—such as the possible extension of the levy beyond "doing business" to deriving income from the State", the provisions designed to prevent double taxation of unincorporated business income, where one unincorporated business owns an interest in another, and the like—in the event it should be decided that an unincorporated business tax should be adopted. The foregoing summary of the major features of these taxes does, however, give us a sufficient basis to evaluate the desirability of recommending such a tax for this State.

The foremost issue in reviewing the question is the matter of equity as between incorporated and unincorporated businesses. As matters now stand, the latter escape the entity tax now borne by corporations. We have already concluded above that neither the historical justification, the asserted special privileges of corporations, nor the size and wealth of corporate enterprises, taken as a whole, warrant a special tax on corporations not borne by unincorporated businesses. The last point is emphasized by the fact that about 70% of all the corporations reporting under the Corporation Business Tax for 1968—approximately 91,500 out of 132,500—paid less than $200 in tax. (Annual Report for 1970, Division of Taxation, p. 186).

Nevertheless, the unincorporated business taxes outlined appear to us to be crude instrumentalities for eliminating the inequality between corporations and unincorporated businesses, and have, indeed, introduced new inequalities. At the outset, the disallowance of salaries to proprietors, and the substitution of the proprietor's allowance, with ceilings of $5,000 and/or 20% of taxable income, appear to us to be both unrealistic and highly preferential to corporations. Under a net income tax, officers' or proprietors' salaries—more reasonable in amount for their services—ought to be allowed. Yet, under the law, a vice-president in an engineering consultant corporation may doubtless earn $50,000 or $75,000, and ordinarily this would be readily deductible as a reasonable salary. But given an engineering-consultant partnership, the maximum proprietor's allowance for an experienced, managing partner, under the New York provisions, would be $5,000; at current markets, this is probably less than half the amount the firm would have to pay to a raw recruit from an engineering school. Even in less prestigious businesses, such as small retail stores, repair businesses and the like, the proprietors' allowances—based apparently on 1937 standards—are inadequate and discriminatory vis-a-vis corporations.

This can, of course, be cured by eliminating entirely or by adjusting the ceilings on the proprietors' allowances to the salaries paid such employees in comparable corporate or non-corporate posts. The consequence, however, of such equalization of allowances may well be to diminish the revenues from the tax so markedly as to raise the question whether its adoption is worth the administrative and compliance costs involved.

There are, however, other methods that have been employed in some taxing statutes to deal with salaries of small corporations that are managed by their proprietors that may be considered. Thus, the New York State corporate franchise tax, in one of its alternatives, uses a special formula for determining the minimum net income base of the tax, (N.Y. Tax Law, Sec. 210-1), which is computed as follows:

(a) 30% of the corporation's net income; plus

(b) All salaries and other compensation paid to officers and owners of more than 5% of the corporation's stock;

(c) Minus $15,000 and any net loss for the year.

The 30% of net income add-back and the $15,000 special deduction may be inadequate for our purposes, but the general technique employed deserves exploration.

If an unincorporated business income tax should be adopted, a determination would have to be made as to whether to tax persons practicing the professions, whether to exempt only the time-honored traditional professions, and whether to exempt, as does the District of Columbia, all personal service businesses in which capital is not a material income producing factor. The analysis set out above reflects our view that the traditional ground for taxing corporate enterprises but not unincorporated ones, namely, the special privileges of incorporation, no longer obtains in 1970. This likewise suggests the conclusion that the basis of the exemption of the traditional professions from the unincorporated business tax—law, medicine and dentistry, and architecture—namely, that they cannot incorporate—appears to us not to warrant a difference in tax treatment. There is now, however, a more conclusive answer; as a result of the adoption by New Jersey of the Professional Service Corporations Act, even lawyers and doctors may incorporate. (N.J. Stats. Ann. Title 14A-17). Accordingly, under an unincorporated business tax, there appears to be no good reason for singling out any group of professionals for exemption.

If such a levy were to be enacted, it would appear sound to follow the recent New York City amendment of taxing professionals.

Nor are we persuaded that there is any greater merit in the sweeping exclusion by the District of Columbia of personal service enterprises from the unincorporated business tax. We have observed in our consideration of the sales and use taxes that the tendency over the country is increasingly to broaden these taxes to cover services, not merely sales of tangible personal property, and we have recommended that this be done under our sales and use tax. The favoring of service enterprises over manufacturing, selling and other industries in taxation, may have grown out of the feeling that service businesses, requiring little capital, tend to be small businesses and are produced by the sweat of the owner's brow, whereas capital intensive industries are owned by men of wealth who use other people's labor. This may frequently still be the case, but it is a distorted picture. Many rapidly expanding service businesses do require substantial amounts of capital to meet their payrolls, rent, supplies, etc. for their large staffs of employees, to wit, advertising agencies, engineering firms, law and accounting firms, medical groups, and the like. Consequently, we would recommend that if an unincorporated business tax is enacted, the Legislature should reject the broad personal service exclusion employed in the District of Columbia tax.

There is one other aspect of the professional and service area to be considered. If an unincorporated business tax were to be enacted, which applied to professional and service enterprises, as does the New York City levy, there might be a wholesale movement of lawyers, doctors, and others engaged in service businesses to form Professional Services Corporations, in order, in part at least, to avoid the tax. Presumably a Professional Service Corporation is subject to the Corporation Business Tax, and normally pays only the $25 minimum tax. Over the country many professionals have formed Professional Service Corporations, principally in order to obtain Federal income tax fringe benefits. Conceivably, the enactment by this State of the unincorporated business tax might produce an additional impetus to such incorporations. We do not desire to be understood as being critical of professionals who take advantage of the opportunity granted by our Legislature to incorporate, but merely to deal with the revenue aspects, and to conclude that the more successful professionals and other service businesses may resort to service corporations, in part to avoid the unincorporated business tax; and that as a consequence the anticipated revenues may be substantially reduced.

Based on the foregoing analysis, it is our conclusion that a net income tax on unincorporated businesses should be added to the New Jersey business tax structure, but that the problems outlined above require further study before a viable, acceptable proposal can be recommended. Such study is, we believe, required in order to frame a statute that will do equity as between corporations and unincorporated businesses; that will exempt entirely, or keep at a minimum, the burden of the tax, and the costs of compliance, on the numerous small, individual proprietorships and partnerships over the State; and that will close up loopholes, such as the use of the Professional Service Corporation, which may serve as an escape from the tax. And, if it is to be adopted, the estimates should indicate a sufficiently high revenue yield to warrant the imposition of the tax.

There are, in addition, a good many technical problems that must be resolved in achieving these objectives. Thus, we would favor exempting from the tax all businesses that do not realize a stated level of gross receipts, perhaps $100,000, during the taxable year. In so doing, however, equity would seem to require a notch provision, so that a business with slightly larger gross receipts would not be subject to a substantial tax. If, for example, the tax were levied at the New York City 4% rate, without a notch provision, a business with $100,000 of gross receipts, and a net income of $10,000, would pay no tax, whereas the business with $100,100 in gross receipts and the same net income, would pay $400 in tax. Conceivably, a provision such as New York's decreasing credit of $100-$200, which is designed to smooth out such jumps, would be an appropriate method to solve these problems. We use this example to illustrate the need for detailed study of various aspects of a net income tax on unincorporated businesses, before it will be ripe for recommendation to the Legislature.

The Committee recommends:

The existing gross receipts tax on unincorporated businesses should be repealed and that the proposed Committee on Tax Legislation should consider as a replacement a possible net income tax on unincorporated businesses and develop a concrete proposal for submission at a later session of the Legislature.

Retail Gross Receipts Tax

The Retail Gross Receipts Tax was born in 1966 with the passage of the Business Personalty Tax Replacement Program. It is a levy of 1/20 of 1% on gross receipts of all retail stores which have sales in excess of $150,000 per year. Establishments grossing less than $150,000 but more than $125,000 are exempt but must file a financial statement; those grossing less than $125,000 are exempt from both payment and filing. The yield has been:

1971	4,582,210
1970	3,948,827
1969	3,837,995
1968	3,480,321

The revenue from this tax is used to provide monies to municipalities to replace a portion of that revenue lost when local business property taxes were abolished in 1966. The tax, singularly, is directed at a particular class of taxpayer and is inherently inequitable.

The Committee recommends:

The retail gross receipts tax should be abolished upon the adoption of the comprehensive revenue proposals of this Report.

Business Personal Property Tax

The Business Personal Property Tax is levied upon the tangible personal property used in business in New Jersey by individuals, partnerships, corporations and other establishments engaged in trade. The tax is assessed on the basis of 50% of original acquisition cost to the taxpayer. The rate is currently $1.30 per $100.00 of such cost of the property as shown by the books of the taxpayer. The yield is paid to the State Treasurer and is used as a portion of an annual $106,835,188 distributed to municipalities under the Business Personalty Replacement Act of 1966.

Revenues received from business personal property tax have been as follows:

1971	$50,978,295
1970	45,842,490
1969	41,950,322
1968	21,734,247

While the personalty tax has little philosophical appeal, an increase in the rate only serves to offset revenue lost from the proposed exemption of productive machinery from the sales tax. This would require an increase in the rate from $1.30 per hundred to $2.00 per hundred to produce an additional $25,000,000.

A comparison with the burden of a sales tax due and collectible on productive machinery at the time of purchase will show that the business personalty tax has the effect of deferring tax payments until production benefits from such machinery are achievable. To the Committee, this represents an acceptable compromise. Were a reduced real property tax, in relatively higher property tax areas, not a component of tax reform with its attendant beneficial reduction in business real property tax, the Committee might be less inclined to continuation of the tax as a revenue source.

While filing and collection procedures function smoothly, there sometimes exist difficulties in making a determination between "real" property and "personal" property. Municipalities, seeking to expand their revenue, benefit from business property classified as "real", while most businesses would prefer to have more property classified as "personal", paying to the State a generally lower rate. Instances occur where the taxpayer is whipsawed by having property deemed to be "real" by the municipality and deemed to be "personal" by the State.

The problem of property class definitions has been dealt with more comprehensively in other states than in New Jersey. To clarify problems of interpretation in New Jersey, it is recommended that definitions be established by the Director of Taxation, and that such definitions be given the force and effect of law in relation to local assessments.

The Committee recommends:

The tax rate of the business personal property tax should be increased from $1.30 per hundred to $2.00 per hundred on the previous base;

The Director of Taxation should be authorized by law to promulgate definitions of real and personal property within the meaning of the statute and to make binding determinations thereof.

The present distribution of replacement revenues to the municipalities should be continued unaffected by the recommended repealers.

Chapter VI

Taxation of Banks and Other Depositary Institutions

The Constitutional and Statutory Restrictions on State Taxation of National Banks

The celebrated case of *McCullough v. Maryland,* decided in an opinion by Chief Justice Marshall some 150 years ago, was the fountainhead of the immunity of national banks, as instrumentalities of the Federal Government, from any kind of taxation by the States, in the absence of Federal consent.[1] And three years ago, the Court reaffirmed this view, in holding that national banks cannot be subjected to State sales and use taxes imposed generally on purchases for their own use of tangible personal property.[2]

For more than a century, since 1864, a year after the passage of the original National Bank Act, Congress has waived a part of this immunity, by consenting to specified levies that the States may impose on national banks.[3] Prior to the 1969 amendments discussed below, under the Congressional waiver of immunity, the States were permitted to impose only the following types of taxes on national banks and their shareholders:[4]

1. Real property taxes on the property of banks.

2. Any one of the following taxes may be imposed on a national bank by the State in which its principal office is located, but the imposition of one of the four types of taxes enumerated precludes the use by a State of any of the others:

   a. A tax on bank shares. Under this provision, a number of States impose the tax on the shareholders of the bank, whereas in other States the tax is on the bank itself, and is measured by the value of its capital structure (capital, surplus and undivided profits).

   b. Under a net income tax, shareholders of banks may be taxed on the dividends received on their stock.

   c. A net income tax on the banks.

   d. A franchise or excise tax on the banks, measured by net income.[5]

The statutory provisions are hedged in by restrictions designed to prevent discriminatory taxation of national banks; they also restrict the taxation of bank shares owned by non-residents to the State in which the bank's principal office is located.[6]

This legislation defining the types of taxes that the States may impose on national banks inevitably affected State taxation of other competing lending institutions—domestic commercial banks, savings banks, savings and loan and building and loan associations. As a result, a recent survey of State bank taxation concluded that "differences in tax treatment of national and State banks has not been widespread or substantial."[7] More than half the States levy an income tax on banks, which accounts for over half the taxes collected from banks, other than real property taxes.[8] Most of the remaining States tax bank shares.[9]

New Jersey has opted for the tax on bank shares in the form of a tax on the net worth of the bank,[10] as is described below.

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1 4 Wheat. 316 (1819).

2 First Agricultural National Bank of Berkshire County v. State Tax Commission, 392 U.S. 339 (1968).

3 Section 5219, Revised Statutes; 12 U.S. Code 548.

4 The statute was amended in 1868, 1923, 1926, and most recently in 1969.

5 This provision, which came into Revised Statutes 5219 in 1923, was designed to permit the State to include in the net income base, income from Federal securities, by the use of an excise tax measured by net income. The Supreme Court had held that such income may not be taxed "directly" by an income tax, but that it may be included in a net income measure of a franchise or excise tax. Weston v. Charleston, 2 Pet. 449 (1829); see Pollock v. Farmers Loan & Trust Co., 157 U.S. 429, 524 (1895); Flint v. Stone Tracy Co., 220 U.S. 108 (1911); see Plummer v. Cole, 178 U.S. 115 (1900). This distinction is embodied in the Federal Public Debt Statute, 31 U.S. Code 742.

6 The history of Section 5219, which has given rise to extensive litigation, particularly with respect to the provisions designed to prevent discriminatory taxation against national banks, is traced in Simeon E. Leland, "History and Influence of Section 5219", which appears in "State and Local Taxation of Banks", Report of a Study Under Public Law 91-156, Appendix 6, prepared by the Board of Governors of the Federal Reserve System for the Senate Committee on Banking, Housing and Urban Affairs (92d Cong., 1st Sess. 1971). This Report is referred to below as "the Bank Tax Study".

7 Bank Tax Study, note 6, supra.

8 Idem, p. 15.

9 Idem, p. 16.

10 Rev. Stats., Sec. 54:9.

Public Law 91-156

The decision of the United States Supreme Court, handed down in 1968, holding that the States were not empowered to impose sales or use taxes on national banks,[11] precipitated Congressional intervention and a reexamination of the power of the States to tax banks. As a consequence, Congress adopted a two-pronged amendment to Section 5419, temporary provisions to remain effective through the end of 1971, and permanent provisions to become effective on January 1, 1972. The interim provisions accomplish the following (PL 91-156):

1. They authorize the States and their political subdivisions, in addition to their taxing powers under Section 5419 as it then existed, to levy on a national bank having its principal office within the States, any tax (other than a tax on intangible personal property) which is imposed generally on a non-discriminatory basis throughout the jurisdiction, in the same manner and to the same extent as the tax is imposed on banks organized under the laws of the State.

2. They also authorize the imposition of the following taxes on national banks that have their principal offices outside the State, if they are imposed generally throughout the State on a non-discriminatory basis:

   a. Sales and use taxes.

   b. Taxes on real property or the occupancy of real property within the jurisdiction.

   c. Documentary stamp tax and levies on the execution, delivery or recording of documents.

   d. Taxes on tangible personal property (excluding cash and currency) located in the State.

These are the temporary provisions, but effective on January 1, 1972, the States will obtain greater freedom to tax national banks, unless Congress takes further action in the meantime. Under the permanent provisions of PL 91-156, all immunity of Federal banks from State taxation under the intergovernmental immunity doctrine will be waived by the following provision:

> "For the purposes of any law enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located." (Sec. 2(a)).

In proposing this two-step statute, Congress recognized that there were a number of controversial unresolved problems. It accordingly directed the Federal Reserve Board to:

> "make a study to determine the probable impact on the banking systems and other economic effects of the changes in existing law to be made by section 2 of this Act governing income taxes, intangible property taxes, so-called doing business taxes, and any other similar taxes which are or may be imposed on banks."[12]

The Board's recommendations made in the Bank Tax Study are as follows:

1. The restriction contained in the interim legislation with respect to ad valorem taxation of the intangibles held by national banks should be continued, and the denial should be extended to intangibles held by State banks and other depositary institutions.

2. Congress should limit the circumstances in which national banks, state banks, and other depositary institutions may be subjected by State or local governments to taxes on, or measured by, net income, gross receipts or capital stock, or to other "doing business" taxes, in a State other than the State of the principal office, and prescribe rules for such taxation.

3. Congress should prohibit the imposition of discriminatory or more onerous license, privilege or other similar "doing-business" taxes on banks and other out-of-state depositary institutions than would be imposed if chartered by the taxing State.

4. The Federal public debt statutes should be amended so as to authorize the States to include in the measure of otherwise valid direct net income taxes the income realized by banks and other depositary institutions.

5. Congress should establish a uniform national rule that coins and currency should be considered, for State and local intangible personal property tax purposes, as intangible property.

Although the Federal Reserve Board had been directed by Congress to report the results of its study by December 31, 1970, in order to enable Congress to reconsider the whole matter before the permanent provisions became effective, the report of the Bank Tax Study was not completed and sent to Congress until May, 1971. As a consequence, a joint resolution has been introduced in Congress to postpone the effective date of the permanent amendments for another two years, until January 1, 1974.[13] It is expected that Congress will act favorably on the measure in order that it may have time to reconsider the matter, in the light of the Federal Reserve Board's recommendations.

The Existing Tax Structure as Applied to Banks and Other Depositary Institutions

The taxation of banks by the State has not changed its essential character in more than 50 years, doubtless

[11] See note 2, supra.

[12] See "State Taxation of National Banks", Report of Senate Committee on Banking and Currency to Accompany H.R. 7491, p. 6, Senate Rep. No. 91-530 (91st Cong. 1st Sess., Nov. 12, 1969).

[13] S. J. Res. 137.

because of the restrictions on the power of the States to tax national banks. The Bank Stock Tax, enacted in 1914, is still the only tax imposed on banks in the State, other than the real property tax, the sales and use tax, and miscellaneous levies. While the income tax has been added to the net worth tax, as a major development in the taxation of corporations generally, this levy has not been employed in bank taxation.

The Bank Stock Tax, which in nomenclature is an intangible ad valorem levy on the shareholders of banks, in practice, is a tax levied on banks and is measured in substance by the value of its capital stock.[14] That is due to the fact that the statute permits the bank to assume the tax, in which event the bank becomes the taxpayer,[15] and that has become the actual practice. The value of the bank's stock is determined under the levy by its capital, surplus and undivided profits; a deduction is allowed for the assessed value of its real property.[16] Prior to 1970, the value attributable to preferred stock was not taxed, but that rule was changed by the Legislature, which at the same time doubled the tax rate, raising it from ¾% of 1% to 1½%.[17] The tax yielded $7,843,000 in revenues in 1971.

Not all banks located in the State are subject to the Bank Stock Tax; savings banks are exempted by the explicit language of the statute.[18] And savings and loan associations and building and loan associations are not subject to the tax because the levy applies only to "shares of capital stock of banks".[19] These depositary institutions do not issue capital stock. Moreover, like commercial banks that are subject to the Bank Stock Tax, savings banks, savings and loan associations and building and loan associations, although not reached by the Bank Stock Tax, are expressly exempted from the Corporation Business Tax.[20]

The Financial Business Tax, was enacted in 1946. It taxes industrial banks, personal finance and small loan companies, sales finance and mortgage finance businesses, dealers in commercial paper, and others employing monied capital in substantial competition with national banks.[21] It is designed as a counterpart to the Bank Stock Tax and is levied on "net worth", at the rate of 1½%. By explicit proviso, commercial and savings banks, savings and loan associations, and building and loan associations are exempt from the Financial Business Tax.[22] This tax yielded approximately $3,581,862 in 1971.

The tax structure resulting from the statutes referred to is that commercial banks are subject to a tax of 1½% on the value of their capital stock and other non-depositary institutions, engaged in lending money and related financial activities, are subject to a 1½% tax on their net worth tax,[23] whereas mutual savings banks, savings and loan associations and building and loan associations pay neither of these levies nor the Corporation Business Tax.

Steps should be taken to insure that companies subject to the Financial Business Tax should carry their fair share of the State's tax burden, as compared with other corporations, at such time as the bank stock tax is revised.

Possible Modification of the State's Tax Structure as Applied to Banks and Other Depositary Institutions

Apart from the sweeping elimination by the permanent provisions of PL 91-156 of pre-existing limitations on the power of the States to tax national banks —powers which appear likely to be curtailed, at least to some extent, in view of the recommendations made by the Federal Reserve Board—the temporary provisions of PL 91-156 have opened up an important new avenue for State taxation of national banks whose principal offices are located within the State. In addition to the other permitted taxes that Section 5219 had authorized for decades, the 1969 legislation permits the States to impose on such national banks, whose principal offices are located in a State, any tax (other than a tax on intangibles), which is levied on the State's domestic banks. This means that for the first time, New Jersey can impose a combined net income and net worth tax to national banks, so long as the same tax is applied to banks chartered by the State.

The lack of power to extend to national banks the principle of the Corporation Business Tax, embracing both the net worth and net income levy, proved a serious obstacle to attempted reform in the State's tax structure, when the matter was last considered by the State Legislative Committees in 1969.[24] It appeared

14 N.J. Rev. Stats., Sec. 54:9.

15 Sec. 54:9-14.

16 Sec. 54:9-4.

17 Sec. 54:9-7, as amended by Laws of 1970, Ch. 8.

18 Sec. 54:9-3.

19 Sec. 59:9-2.

20 Rev. Stats., Sec. 54:10A-3(b).

21 N.J. Rev. Stats., Sec. 54:10-B. See Commission on State Tax Policy, *First Report* (1946) pp. 1-41.

22 Sec. 54:10-B(2).

23 There are differences in the bases of the two types of tax, but in their essential characteristics, the Bank Stock Tax and the Financial Business Tax are both levies on the net worth of the enterprise.

24 See Public Hearings Before the Assembly and Senate Committees on Taxation on Assembly Bills Nos. 1075, 1078, 1079 and Assembly Concurrent Resolution No. 95 (Sept. 1969); and the testimony of Sidney Glaser, Director, Division of Taxation, p. 23, et seq., PL 91-156 was not enacted until December 24, 1969.

to be recognized during the hearings that the existing tax structure, as applied to lending institutions, was unsatisfactory and discriminatory. Now that PL 91-156 has placed a combined net income—net worth tax on national banks, and hence in turn, on State banks and other depositary and lending institutions, within the power of the State for a probable period of at least two years, it appears appropriate to reexamine the State's bank tax structure.

The principal alternatives available to the Legislature, in the light of the present posture of the Congressional immunity provisions, appear to be as follows:

1. Application of the Corporation Business Tax to all depositary institutions and other financial businesses, as a substitute for the Bank Stock Tax and the Financial Business Tax; and, if it is deemed warranted, it may be permissible to apply preferential rates to savings banks, savings and loan and building and loan associations.
2. Retention of the Bank Stock Tax and the Financial Business Tax for those businesses to which they now apply, and bringing savings banks, savings and loan associations and other non-taxed depositary institutions into the coverage of the Financial Business Tax at the same rate, or if deemed appropriate at a somewhat reduced rate or rates.
3. Substituting a net income tax for the Bank Stock Tax and the Financial Business Tax, and applying the income tax to savings banks, savings and loan associations and other depositary institutions at the same rate, or if deemed appropriate, reduced rate or rates.

This enumeration of alternatives raises the key issues as to how far banks and other depositary institutions should be taxed, as compared with other businesses; and whether there are economic or social considerations that dictate preferential tax treatment for such institutions. It also presents the question as to whether, as vigorously contended by mutual banks and savings and loan associations, they perform different economic and social functions than those of commercial banks and other lending institutions, in that they are mutual associations, serving primarily the home mortgage market for the great mass of ordinary citizenry; and that to tax them in the same way as stockholder-owned commercial banks or personal loan or finance companies is a grievous error.

Like all proposals to change a State tax structure, in considering these proposed changes, it becomes necessary to weigh the impact of increased taxation of banks and lending institutions on the financial health of the State's banking system; and their competitive position of these New Jersey enterprises vis-a-vis New York and Pennsylvania banks and other competing institutions.

There are also a good many policy and technical problems to be considered in implementing these alternative proposals, which could seriously affect the revenues to be raised. Thus, the base of the Bank Stock Tax excludes the value of real property owned by the bank or a wholly-owned subsidiary, whereas only the equity in real estate owned is deducted in determining the net worth base of the Financial Business Tax;[25] and no deduction is provided for real property under the net worth portion of the Corporation Business Tax.[26]

More serious problems are presented by the net income measure of the tax. If a net income tax were to be imposed on banks and other depositary institutions, it appears likely that administration and compliance considerations would dictate that the base of the tax be modelled after the Federal income tax (except for the elimination of the Federal deduction allowed for the State net income tax). The Federal income tax base, as applied to commercial and savings banks and savings and loan associations has, however, been substantially reduced below the usual corporate base, largely because of the treatment of tax exempt interest income, the allowance of a deduction for interest paid to depositors, and provision for bad debt reserves.

Depositary institutions, like other taxpayers, are exempt from Federal income tax on the interest from State and local securities, but, unlike other taxpayers, who are denied a deduction for interest paid on funds borrowed to purchase exempt securities, such institutions, using deposits with them to finance such purchases, nevertheless obtain a full interest deduction for interest paid to depositors.[27] Moreover, until 1969 the actual experience reveals that the bad debt reserves of banks for income tax purposes were greatly in excess of their actual bad debt experience.[28]

Largely as a result of the operation of these provisions, statistics presented to Congress during the consideration of the Tax Reform Act of 1969 showed that commercial banks, savings banks and savings and loan associations paid significantly less Federal income tax than corporations in general. The taxable net income of banks was substantially lower, in relation to their economic income, than that of other businesses.[29] While the bad debt reserve provision was

[25] Sec. 54:9-4; Sec. 54:10B-6. There are some other differences in this deduction under these two taxes.

[26] Sec. 54:10A-4(d).

[27] Rev. Proc. 70-20, 1970—2 Cum. Bull. 499; Rev. Rul. 61-222, 1961—2 Cum. Bull. 58. See Donald I. Halperin, "Federal Income Taxation of Banks", 64th National Tax Ass'n Procs. 1971.

[28] See U. S. Treasury Department, "Tax Reform Studies and Proposals", Part 3, pp. 461-462 (1969).

[29] Idem, at pp. 460-461. See also, Harvey E. Brazer and Marjorie C. Brazer, "Comparing State and Local Taxation of Banks and Other Business Enterprises", Bank Tax Study, Appendix 9, note 6, supra.

modified by the Tax Reform Act of 1969 so as to bring financial institutions (and particularly commercial banks as distinguished from mutual savings and savings and loan associations) more closely into line with their actual experience, it is still too early to know how far this gap between bad debt deductions and actual bad debt experience is being closed.[30] All this indicates that there is considerable uncertainty that a net income tax modelled after Federal levy, if imposed by the State on banks and other depositary institutions, would be comparable in impact to the net income tax component of the Corporation Business Tax, as applied to other industries.

There is another feature of possible revision of the taxes on lending institutions that should be considered, in view of the broadened powers of State taxation of interstate businesses and the growth of the multistate bank, namely, the possible desirability of obtaining a greater contribution to the State's mounting revenue requirements by out-of-state banks that engage in regular and extensive lending activities to businesses and residents of the State. The Bank Tax Study points up the magnitude of the lending activities of out-of-state banks. A 1955 Federal study by the Federal Reserve showed that 29 per cent of all business loans outstanding of member banks had been made to out-of-state borrowers; and the percentage has doubtless risen since. In the case of some financial center banks, it appears that half or more of their lending is to out-of-state borrowers.[31] This trend raises questions as to the competitive position of New Jersey banks with the large multistate banks making loans to businesses and individuals in the State. At the same time, it touches on the importance of having funds available to New Jersey borrowers under most advantageous terms, whether from the money market centers or the local money market.

As the Congressional legislation now stands, not until the permanent provisions of PL 91-156 become law, if that should occur, will the State be able to impose income taxes, capital stock taxes or bank share taxes on out-of-state national banks, even though they may be conducting an extensive loan business with New Jersey borrowers, and engaging in a broadening scope of ancillary activities in the State that are increasingly being carried on by banks.[32] The Federal Reserve Board has recommended to Congress that the permanent provisions of the bank tax legislation should empower the States to impose net income taxes, capital stock taxes or other doing business taxes on out-of-state national banks, state banks and other depositary institutions, but subject to restrictions and safeguards not now contained in PL 91-156. The Report recommends that jurisdictional standards be imposed for determining the State's jurisdiction to tax and that a uniform division of income, or other tax bases, among the states, be established.

If a revision of the State's tax laws applicable to commercial banks, savings banks, savings and loan associations and building and loan associations, were to be undertaken at the present time, the revision could not reach out-of-state national banks that operate and compete in the New Jersey market. This may be possible after Congress acts on the Board's recommendations.

Our broad conclusion is that a review of the State's taxing structure, as applied to lending institutions, is very much in order, but that thorough-going changes must await the action of Congress. Nevertheless, we cannot regard with equanimity the current complete escape by savings banks, savings and loan associations, building and loan associations and other lending institutions of the type of levy imposed on commercial banks, financial businesses and general businesses. We do not believe that this condition should be permitted to continue, while waiting perhaps two years for Congressional action.

From the testimony presented to the Legislative Committees in the 1969 tax hearings and the data gathered at that time, it appears that, as an interim measure, the most appropriate step to be taken to remedy this gap in our tax laws, would be the enactment of a tax measured by net income, at the rate of 5%, on the net income of lending institutions not subject to the Bank Stock Tax, the Financial Business Tax or the Corporation Business Tax. We are aware, as set out above, of the erosion of the tax base that the proposed tax will entail; and that it is likely that the savings banks and other depositary institutions affected by the proposal will bear a lower tax burden than commercial banks and corporations subject to the Financial Business Tax. Our proposal does involve at least a tentative acquiescence in the contention made by those institutions that they should have some preferential tax treatment, a premise that ought to be reexamined at a later date. We regard our proposal, nevertheless, as a desirable first step in developing a tax instrument applicable to these depositary institutions. In the interim, we would propose that a study be undertaken by the proposed standing Commission on

[30] See Tax Reform Act of 1969, Secs. 431-434, I.R.C. Secs. 585, 593; see Daniel Halperin, note 27, supra.

[31] See Bank Tax Study, p. 47.

[32] For a summary of the facts as to how the typical large multistate bank operates over the country in making loans, leasing equipment, handling interchange system credit cards, rendering computer services, and carrying on miscellaneous activities, see Jerome R. Hellerstein, "Federal Constitutional Limitations on State Taxation of Multistate Banks", Appendix 11, Bank Tax Study, note 6, supra.

Tax Legislation of the alternatives outlined above, and of the problems presented, for completion and presentation to the Legislature, after Congress acts on the "permanent" provisions of P.L. 91-156.

In such a study, we would recommend that the Commission consider specifically the possible desirability of extending the tax to out-of-state banks, which compete with New Jersey banks for loans and other business and derive income from the State but which are not "doing business" within the State, as that term has been construed, provided Congress should authorize such taxation.

There is one other related problem affecting financial institutions, which are not banks, that has arisen in the administration of the related Financial Business and Corporation Business Taxes, and has given rise to controversy and uncertainty, to which we believe the Commission should also direct its attention.

Corporations subject to the Financial Business Tax are not taxable under the Corporation Business Tax (N.J. Rev. Stats., Sec. 54:10B-3). A "financial business" subject to the former levy is defined as a business enterprise, not qualifying as a commercial or savings bank, or the like, which "(1) is in substantial competition with the business of national banks and which employs moneyed capital with the object of making profit", in discounting notes, buying or selling exchange, making unsecured loans, investing in bonds, notes debentures, etc. (Id., Sec. 54:10B-2(b)). Border line cases have arisen in which corporations are uncertain whether the operations bring the corporation into the category of a financial or a general business. The dilemma posed for such taxpayers and their counsel is that a return filed under one of the taxes does not start the running of the statute of limitations for assessment on the other; and given the vagueness and ambiguities of the definition of financial business, such corporations fear deficiency assessments years after the filing of returns, with interest and penalties, under the Corporation Business Tax if they filed as financial businesses, and vice-versa if they filed as general businesses. (See N.J. Rev. Stats., Sec. 54:10A-19 and Sec. 54:10B-18). Whether the proper solution lies in a clarification of the definition of financial businesses, or in a reciprocal extension to the two taxes of the blanket of the statute of limitations for a return filed under either law, is a matter which the Commission should consider.

The Committee recommends:

As an interim measure pending further Congressional action on the taxation of banks and other depositary institutions, that a net income tax at the rate of 5% be imposed on lending institutions that are not now subject either to the Bank Stock Tax, the Financial Business Tax or the Corporation Business Tax; that further study of the tax structure of the State, as applied to commercial and savings banks, savings and loan associations and other lending institutions, be undertaken by the proposed Commission on Tax Legislation but that additional legislative action be postponed pending further Congressional action with respect to the limitations on the powers of the States to tax national banks, and that the proposed Commission review the statute of limitations on assessments under the Corporation Business Tax and the Financial Business Tax, in view of the uncertainties under the present law as to which tax is applicable to some types of businesses.

Chapter VII

Taxation of Insurance Companies

New Jersey, like most other states, imposes a premium tax on insurance companies and exempts them from the general corporation and franchise taxes paid by other kinds of business. The basic rate of New Jersey's premium tax is two percent, which is also the most common rate in other states. A reduced rate, one percent, applies to group health premiums, while both premiums and annuity considerations are exempt from tax when received under plans which qualify for special treatment under the federal income tax law (referred to as qualified plans).

The above rates apply both to New Jersey companies (domestic companies) and to insurance companies from other states (foreign companies). However, taxable premiums are limited to one-eighth of a company's total taxable premiums received both within and without the state. Domestic companies are also allowed an offset for premium taxes paid to city and county of domicile (reduced by $200,000 for companies with capital and surplus of $15 million or more).

Issues in Insurance Taxation

The unique nature of insurance taxes has created a number of problems not found in the taxation of other kinds of business, and consideration has been given to the following principal issues:

1. How high should New Jersey's insurance taxes be relative to those imposed on other businesses?
2. How is New Jersey affected by discriminatory and retaliatory insurance taxes in other states?
3. Should ability to pay be given more recognition in insurance taxation?
4. Does the premium tax contain serious loopholes?
5. Should the favored tax treatment given Blue Cross and Blue Shield type contracts be continued?

The above issues are briefly reviewed in the following sections.

New Jersey's Insurance Taxes Relative to Those Imposed on Other Businesses

Data submitted to the Committee by representatives of the insurance industry indicates that the present premium tax on insurance companies represents a much higher percentage of their net income than does the State's taxes on other kinds of businesses. While these comparisons are affected by the methods used in establishing reserves, as well as by the special definition of net income employed by the industry, the Committee is convinced that an income tax on insurance companies at the same rate levied on other businesses would produce less revenue than the present premium tax.

This does not seem unfair, though. This tax differential has existed for many years and has, in fact, been narrowed in recent years as taxes on other kinds of business have increased faster than those on insurance. A similar situation exists in most other states and a franchise tax somewhat higher than usual seems justifiable. The insurance industry is exempt from anti-trust laws and is given special supervision and assistance to protect policy holders. In addition, this industry has thus far been given favored tax treatment in that premiums received are exempt from the retail sales tax. In several nearby states, it has recently been argued that, for most types of insurance, the premium represents a charge for services which are not greatly different from some of the services now subject to sales taxes. Thus, in view of the present urgent need for state revenue, the Committee believes that this would not be an appropriate time to reduce the level of insurance taxation.

Discriminatory and Retaliatory Taxes in Other States

About one-half of the 50 states openly discriminate against insurance companies from all other states, either by exempting their domestic companies from taxation or by allowing them to pay a reduced tax. In addition, almost all of the states impose what are known as "retaliatory" taxes on insurance companies from some states. These latter taxes apply only to companies from states with higher taxes than the state which is retaliating. Thus, in effect, each state says to all other states: "If your taxes on my insurance companies are higher than my regular taxes on your companies, I will tax your companies the same as you tax mine."

Discriminatory and retaliatory taxes interfere with business across state lines and such taxes were outlawed long ago for most kinds of business. Thus, few people know that such taxes still exist in the insurance field. However, for many years the Supreme Court ruled that the business of insurance was not interstate commerce and, therefore, was not subject to any administration, supervision, or limitation by the federal government. When the Court began to change its mind in this area, representatives of the insurance industry prevailed upon the Congress to pass the McCarron Act, which has been construed as permitting discriminatory and retaliatory taxes on insurance.

Discriminatory taxes affect New Jersey because they place this State's insurance companies at a disadvantage, relative to domestic companies, in competing for business in one-half of the 50 states. This obviously affects the State's economy by limiting somewhat the amount of business activity within New Jersey.

Retaliatory taxes are primarily designed to make it unattractive for any state to increase its premium taxes. Since the New Jersey premium tax is already as high as that in many states, any increase in the New Jersey tax would cause its domestic companies to pay additional taxes in other states—for each dollar of additional revenue to New Jersey some domestic companies would pay as much as $10 additional to other states.

Since discriminatory insurance taxes diminish the amount of business activity in New Jersey and retaliatory insurance taxes virtually preclude any increase in this State's level of insurance taxes, and since these oddities in taxation have been fostered by an act of Congress, this Committee recommends that the members of Congress from this State should be urged to initiate corrective legislation.

Ability to Pay in Insurance Taxation

The premium tax, like any gross receipts tax, gives no recognition to ability to pay and must be paid even by companies that are losing money. This tax also entirely ignores an increasing amount of insurance company activity in the investment area, where traditional type investments in businesses operated by others are rapidly being replaced by investments in businesses operated by the insurance company. Thus, the premium tax not only ignores ability to pay but allows insurance companies to operate real estate developments and other businesses without paying all of the taxes required of their competitors. In the long run, this tends to limit the tax-paying capacity of the competitors.

The Committee, therefore, recommends that a tax based on income of insurance companies should be substituted for a portion of the present premium tax. It is also suggested that, in defining taxable income of insurance companies, New Jersey should make its tax base broader than the comparable federal tax base, which appears to be unduly restricted in comparison with the income tax base applying to other types of business.

Complete replacement of the premium tax is not recommended for two reasons. First, as pointed out earlier, an income tax would produce less revenue than the premium tax unless it were imposed at a higher rate than on other kinds of business. Second, a tax based entirely on income would produce such enormous shifts in the amount of tax paid by various types of insurers and individual companies that it might prove even less satisfactory than the premium tax, to which the industry is now reasonably well adjusted.

Premiums Tax Inequities

Three loopholes in the premium tax have been brought to the Committee's attention. First, non-insured employee health and welfare benefit plans evade taxation; second, a new type of group insurance policy is especially designed to evade taxes; and third, taxes can be evaded when insurance is placed with a foreign insurance company not admitted to do business in New Jersey and is then reinsured and serviced by a foreign company that is admitted to do business in this State.

Non-insured employee health and welfare benefit plans, unlike self-insurance of the risks faced by an individual or a business, involves an employer in covering the risks of other persons. Thus, the employer becomes an insurer and, as such, should not only pay the same taxes as an insurance company, but should be supervised in the same manner and required to meet the same prudent standards as an insurance company.

The new type of group insurance policy especially designed to evade taxes involves a subterfuge under which the insurance company collects a greatly reduced premium from the employer (only about 5% to 10% of the normal premium). The difference between the normal premium and the reduced premium is then deposited in a special bank account in the employer's name, from which the insurance company pays most of the claims under the policy. It is argued that no tax is due on the amount deposited in the special bank account because the employer is, in effect, acting as a "self-insurer". As was pointed out relative to non-insured employee health and welfare benefit plans, benefits for third parties are involved, which makes the employer an insurer who should be taxed, provided he actually assumes a sufficient portion of the risks formerly borne by the insurance company to justify a reduced tax on the insurance company. In this instance, the duty of the employer to pay any premium tax not paid by the insurance company seems evident even under present law, since the obligations of the employer, as well as of the insurance company, are provided for in a document legally designated as an insurance policy.

The third loophole in the premium tax involves insurance purchased from foreign insurance companies, not admitted to do business in New Jersey, with the transaction handled in such manner as to legally occur outside the State. A long-standing example of this loophole is "mail order" life insurance and health insurance. Fortunately, it appears that "mail order" insurance will continue to be more of an irritant than a serious threat to State revenue. Since all servicing, as well as the transaction, must be handled by mail, dissatisfaction with such insurance seems to keep the volume relatively low.

Much more serious in its potential effect on State revenue is the increased use of this loophole by business firms in purchasing group insurance as well as property and liability insurance. When the representatives of a New Jersey business firm travel outside the State and purchase insurance from a foreign insurance company not admitted to do business in New Jersey, the revenue loss on a single policy can be substantial. This loophole is also becoming attractive because adequate servicing of such policies can apparently be provided, without incurring any New Jersey tax, by having the policies ceded to, and serviced by, a foreign insurance company which is admitted to do business in New Jersey. There seems to be no legal means of taxing either of the insurance companies involved in such a transaction because New Jersey has no jurisdiction over the company writing the policy and the Supreme Court has held that reinsurance provided by a foreign company cannot be taxed (Connecticut General Life Ins. Co. v. Johnson, 303 U.S. 77, 82L.ed. 676, 1937). Thus, any action to close this loophole must seemingly be directed toward the purchaser of the insurance.

To close each of the tax loopholes mentioned above, the Committee recommends that the State enact a new tax on the use of insurance to cover risks within the State. This tax should be patterned after the use tax which supplements the retail sales tax, and the definition of insurance should be broadened to include all employee protection plans, whether handled by an insurance company or funded and administered by the employer. Thus all of the above loopholes would be covered by this one new tax.

As with the use tax which accompanies the retail sales tax, this tax on the use of insurance would apply only when the New Jersey premium tax had not been paid. In addition, to simplify administration, it is recommended that all taxpayers who would otherwise have a tax of $10.00 or less be exempted from the tax. Thus, the tax would apply only when a taxpayer had more than $500 of premiums not subjected to the premium tax. This should avoid any necessity to collect a tax on mail order insurance and most, if not all, taxpayers would be corporations, thereby making it possible to collect this new tax by simply adding a few lines on the present corporation franchise tax forms.

Tax Treatment Given Blue Cross and Blue Shield Type Contracts

Exemption of non-profit hospital and medical insurance plans from the premium tax obviously places insurance companies at a disadvantage in competing for business. Even the reduced premium tax on group insurance (1%) instituted in 1965 leaves a disparity. A study to determine its justification is recommended. If the disparity should prove unwarranted, the tax disadvantage of insurance companies could be eliminated either by taxing Blue Cross and Blue Shield as well as other non-profit hospital and medical insurance plans, or by entirely exempting these coverages from the premiums tax. In view of the extent to which hospital and medical insurance is already exempt from tax, and recognizing the desirability of making such coverages available to all of the State's citizens at the lowest possible cost, the Committee believes that the better course of treatment for hospital and medical payment coverages is to exempt them entirely from the premium tax, whether provided under group policies or individual policies and whether insured or non-insured. The revenue loss from this exemption would be more than offset by closing tax loopholes affecting other kinds of risks, as recommended above, and by restoring the premium tax rate on group insurance to two percent for all risks other than hospitalization and medical payments.

The Committee recommends:

1. The level of taxation of insurance companies should not be changed, and insurance tax revenue should expand as the industry grows.

2. There should be a further study of the entire complex area of taxation of insurance. Present taxing statutes seem to lack a uniformity, appear to leave untouched certain areas, and fail to realize the revenue potential fully. Particular areas of study should be:

a. A tax based on income of insurance companies in conjunction with, or as a partial replacement of, the premium tax.

b. A tax on self insured employer health and welfare benefit plans, whether fully or partially insured.

c. A supplemental tax on the use of insurance to cover risks within the State not otherwise taxed.

d. The propriety of maintaining a premium tax differential between non-profit agencies such as Blue Cross/Blue Shield and competing plans.

3. Insurance companies should be subject to the requirements for filing the notice of business activity which are being recommended by the Committee in the corporate business portion of the report.

4. The surplus line tax of 3% might be changed to 5% without competitive jeopardy or retaliatory effect to the State.

5. The Committee sees little equity in maintaining a one-eighth limitation on the total of premiums (within and without the state) which are subject to the insurance premiums tax on premiums on risks in this State.

6. The list of insurance companies not subject to the insurance premiums tax in the State should be subject to continuing review.

7. The system of discriminatory and retaliatory insurance taxes among the states should be abolished; and to this end New Jersey's representatives in Congress are urged to achieve this goal.

Revenue Effect of Recommendations

While the gain from these recommendations is difficult to predict, it is conservatively estimated that they will produce significant revenues, at least $1.2 million annually, which is not reflected in the revenue estimates of the Report.

Chapter VIII

Public Utility Taxes

Taxation of public utilities in New Jersey is effected through three basic taxes: a franchise tax, a gross receipts tax and a surtax on both of these. The franchise and gross receipts taxes are assessed by the state and are payable to the municipalities in which the affected utilities are located. The surtax is for state use. In 1971, revenues were $153 million from the franchise tax and the utility gross receipts tax and $20.4 million from the surtax.

The franchise tax is a levy of 5% on the gross receipts of companies, other than railroads, grossing $50,000 or more annually, and of 2% on the receipts of companies grossing less than $50,000 *per annum.* Added to the franchise tax is a gross receipts tax of 7.5% upon gross receipts resulting from business over, on, in through, or from lines or mains in the state and applies to street railway, traction, sewerage, water, gas and electric light, heat and power corporations using or occupying public streets, highways, roads or other public places in the state. This particular tax is paid in lieu of local personal property taxes and is apportioned to the municipalities using a formula based on the ratio of the scheduled property of the utility in the municipality to the total scheduled property of the utility in the state.

Telephone and telegraph companies in the state do not pay a gross receipts tax but are subject instead to a local levy on their personal property. Under Chapter 138, Laws of 1966, the tax is assessed and levied by the taxing district in which such property is located and in 1971 amounted to $49,738,000.

In 1963, the surtax for state use was enacted by the Legislature, effective only for the calendar year of 1964. The expiration date was subsequently eliminated. The tax remains in effect.

The franchise portion of the surtax is composed of a 0.625% excise tax on gross receipts of $50,000 or more, and $.25% on receipts less than $50,000.

The gross receipts surtax is 0.9375% on the gross receipts of water, gas, electric light, heat and power companies, and 0.5% on the gross receipts of telephone and telegraph lines and mains in New Jersey.

Total revenue from public utility taxation has risen steadily without interruption over the past two decades, as follows:

Year	Franchise	Gross Receipts	Surtax	Total
1971	64,390,423.92	88,545,143.22	20,442,352.30	173,377,919.44
1970	59,542,830.02	80,949,844.75	18,822,217.36	159,314,892.13
1965	43,620,984.36	57,300,233.46	13,588,733.63	114,509,951.45
1960	32,363,668.47	39,218,565.87	—	71,582,234.34
1950	14,710,772.45	14,419,221.18	—	29,129,993.63
1940	6,363,399.90	6,418,229.33	—	12,781,629.23

The Committee recommends:

No substantive changes in the public utility tax laws nor does the Committee make a recommendation for any increase in the tax rates, particularly in view of the regressive nature of the public utility tax. (See Part III, p. 29 for the Committee's recommendation requiring municipalities to capitalize revenues from this source for county tax apportionment purposes.)

Railroad Taxation

In 1966, New Jersey passed into law amendments to the Railroad Tax Law of 1948. These substituted a state tax on certain types of railroad property at the rate of $4.75 per $100 of true property value in place of a municipal tax on Class II railroad property. The tax is applicable to all property used for railroad purposes, other than main stem, tangible personal property and facilities used in passenger service.

The tax is used for state purposes, being levied by the Public Utility Tax Bureau and collected by the State Comptroller.

One important result of the 1966 amendments is to provide for the payment of state aid to municipalities which formerly levied a tax on Class II property; so called replacement revenue. The amount of aid granted to a municipality is determined by the amount of tax revenue derived from that property for the year 1966, with adjustments made for additions and/or subtractions of property. In addition, to this figure is added a percentage of the difference between 1966 and 1965 assessments. In 1970, this latter amounted to 70% of that difference; in 1971 it will be 60%; in 1972, 50%; and so on, until the difference is erased. This will effectively provide yearly revenue to municipalities in place of that revenue which they lost when the state took command of railroad property taxation.

In 1970, $11,015,238 was distributed to various municipalities, of which $6,479,551.76 reflected the adjusted level of comparable 1966 assessments.

The rationale for this approach is best summarized by the New Jersey Commission on State Tax Policy in its *Eleventh Report*. "Railroad Taxation in New Jersey —The End of An Era." The Commission wrote, "while this approach will not reflect market value changes from year to year in respective taxing districts, it will recognize, at least in a general way, substantive changes in the Class II valuation base and the approximate effect of these changes on the Class II tax subsidy in subsequent years."

Railroad Franchise Tax

The franchise tax on railroads in New Jersey is assessed at the rate of 10% against the total net operating income of each system, and of each railroad not part of a system, in the preceding year. This income is allocated to the state in proportion to the ratio of the total number of miles of track the railroad operates in New Jersey as compared with the total number of miles of track within the entire system. Thus, a railroad with 30% of its trackage located within the state would find that 30% of its net operating income is subject to the 10% New Jersey railroad franchise tax. Under law, N.J.S.A. 54:29A-1 et seq., there is a current minimum tax of $4,000 on railroads grossing over $1 million annually and a minimum of $100 on those carriers grossing under $1 million per year.

The long term trend of the yield of the franchise tax, with two minor exceptions, has been downward since the early 1950's. Peaking during the Korean Conflict, revenue from this tax fell from $1,698,196 in 1953 to $108,561 in 1961, a drop of over 93%. In 1970, revenue from this source practically disappeared at a low of $97,948.

The franchise tax as a source of state revenue obviously is of no importance at present, and is likely to be minimal, pending a dramatic and substantial reversal of the railroads' present economic condition. The tax does serve as an effective funding device for the costs of regulating the carriers and should therefore be continued without alteration.

The Committee recommends:

The present system of taxing railroads should remain unchanged.

Chapter IX

The Value-Added Tax

What is Value-Added Taxation

The value-added tax is a series of sales taxes. The major characteristic feature of the tax is that it is not concentrated at a single stage of production. Unlike the manufacturer's excise tax or retail sales tax, tax is applied on the value-added margin at each stage of production. It reaches that part of product value which emerges at that stage. It utilizes as its base the economists' concept of value added by manufacturing or commercial activity. If applied universally and without exception, it eventually taxes the entire business value output in a series of fractional pieces, distributed along the various stages of production and handling from a raw material to the final consumer. It thus reaches all the classic factor incomes (wages, interest, rent, and profits) and may thus be viewed as a tax on the total income of the economy.

Although levied on business concerns, value-added taxation differs from a business income tax in that it includes in the tax base not only *net income* but all costs as well, except those consisting of payments for materials, services, and capital equipment which are subject to value-added in the hands of enterprises from whom they are purchased. Thus, the value-added tax base for a business establishment is equivalent to the difference between its total receipts and the amount of its purchases.

There are at least three types of measures for value-added taxation reflecting divergent concepts of aggregate income or product, with the essential difference among them being the treatment accorded business investment. Under the first concept, known as the "gross product" or the "gross income" type, deductions are limited to purchases on current account from outside firms, and depreciation deductions are disallowed. The second concept of value-added taxation, the "net product" or "net income" concept, is closely related to the first, except that depreciation charges are permitted as deductions against the tax base. Under the third approach, the "consumption" concept of value-added taxation, all capital outlays are deductible from the value-added tax base.

Experience Elsewhere

European Economic Community—it is here that the value-added tax has had its greatest use. Under the EEC system, adopted from the French system, the tax covers retail trade and services, as well as manufacturing processes. These countries favor the consumption concept of value-added taxation which helps create neutrality between the use of capital and labor. The purchaser pays the tax on the goods and services he purchases and then collects the tax on his sales. The invoice method of computing the tax is used—the tax is shown on all invoices and taxes paid on purchases are deducted from taxes collected on sales and the net amount is remitted to the taxing authority. The process lessens the enforcement problem since each successive buyer wishes to have evidence of the tax paid by its suppliers to offset from the taxes due on his sales. Accordingly, good accounting records are essential.

The value-added taxes in the European countries were for the most part adopted as an improvement of their general turnover taxes which did not give a credit for the taxes paid at previous stages—producing a "cascade effect" in which the previous tax itself was successively taxed. That system also resulted in a substantial competitive advantage for integrated producers.

Value-Added Taxation In Michigan. Although value-added taxation has become increasingly popular in Western Europe, this experience is of limited usefulness for New Jersey since issues of tax harmonization and international trade which are involved in Europe need not concern New Jersey. The experience of the state of Michigan with value-added taxation from 1953 to 1967 is a more valuable guide.

The Michigan Business Activities Tax (BAT) was collected on the basis of "adjusted receipts" (value-added) and was imposed initially at a uniform rate of .775% except in the case of public utilities, which were subjected to a lower rate of .2%. The Michigan tax was levied generally on all firms and types of businesses. The BAT utilized the gross product approach which was modified only slightly in the direction of a net income concept by allowing depreciation allowances on business real property. The BAT base was computed by subtracting from gross receipts all outlays which were treated under the federal Internal Revenue Code as ordinary and necessary expenses.

Two special allowances were incorporated into the statute causing some departure from pure value-added taxation: a minimum flat deduction of 50% of gross receipts and an additional deduction in computing the tax base when labor costs exceeded 50% of revenues. Exemptions from the BAT were provided for financial institutions and for many nonprofit organizations. The statute also granted a specific dollar exemption for each business taxpayer's first $12,500 of adjusted receipts.

Critics of the BAT argued that this levy ignored principles of ability to pay and placed severe burdens on the low profit and new firm. It was argued that the formation of new firms would be discouraged.

As a means to meeting this objection, a net income credit was designed to give larger tax credits to firms having a small percentage of net income relative to gross revenues. Nevertheless, several other problem areas still remained, and the BAT was repealed in 1967 and replaced by a general business income tax.

Value-Added Taxation Versus A Single Stage Sales Tax

The value-added tax and the single-stage levy may both be regarded as methods of collecting sales taxes. It is generally assumed that both types of taxes are shifted forward to the ultimate consumer through a rise in the prices of consumption goods. Thus, if the tax is imposed through the retail stage, it is expected to be the equivalent of a proportional spendings tax collected directly from individuals on the basis of their consumption outlays. The consumption type of value-added tax applied through the retail stage would require the same rate of tax as that of a single-stage retail sales tax with equal scope because both taxes utilize the same base. The difference is that the value-added technique distributes the base among business firms at various stages of production and distribution while the base of the retail sales tax is concentrated at the final stage of production.

A disadvantage of the value-added tax is that it is not as flexible as a sales tax in reducing regressivity by the use of appropriate exemptions. With value-added taxation, it is more difficult to exempt the taxation at earlier stages of production of inputs which are converted into a final product.

Another major disadvantage of value-added taxation relative to the retail sales tax lies with present federal income tax laws. In the case of the retail sales levy, a portion of the cost is shared by the Federal government, to the extent the sales tax finds its way into the itemized deductions of individual taxpayers. At the present time, there is no provision for allowing value-added taxes at earlier stages of production which are shifted to consumers in the form of higher prices to be deducted on federal tax returns.

One other problem with the value-added tax is that if firms apply a constant markup to costs, including tax, the possibility of pyramiding is much greater under value-added taxation relative to a retail sales levy.

Value-Added Taxation And Corporate Business Taxes

Generally, a tax on the factors of production cause price increases. When a generalized tax such as a value-added levy is imposed on all goods and services, the tax is more likely to be passed on entirely; the consumer being unable to evade the burden by shifting his demand to nontaxed substitutes.

Unlike taxes on inputs and products, general economic theory assumes that taxes on income are not shifted to other parties. In the case of corporate income taxation, it is argued that since the income tax is on profits only, the level of price and output that maximizes profits before tax, also maximizes profits after tax. Hence, the imposition of the corporate tax does not affect the actions of the firm, with the result being lower dividends and stock prices received by stockholders.

If the corporate income tax is not shifted, and an equivalent assessment is not placed upon the unincorporated sector, this method of taxation distorts the allocation of capital and other resources between the corporate and noncorporate sectors. The net worth tax on corporate capital in New Jersey further aggravates the situation by discriminating against capital relative to other inputs. Under these assumptions, less total resources, including equity capital are employed in the corporate sector and more resources are utilized in the noncorporate sector. It is argued that a general value-added tax would eliminate this to the extent that it is borne uniformly on the income sources side by all types of factors and imposes a uniform wedge between factor returns and prices of final products.

On the above assumptions, the substitution of a value-added tax for all business taxes in New Jersey would increase the rate of return from investment in the corporate sector as long as the value-added levy is treated as an element of cost and reflected in price. Of course, the impact of such a substitution would not be the same for all industries.

A substantial redistribution of tax payments between industries and firms would result from the substitution of value-added taxation for the present system of assessing business in this state. The table below indicates how a group of eight firms would fare under an alternative method of assessment yielding the same revenue in total from the group. As can be seen from the table, firm G benefits substantially if value-added taxation were substituted for corporate business taxation, while firm D would be considerably worse off. The other six firms are all made better or worse off but to a much smaller degree.

The point to be made, however, is that although one of the claimed advantages of the value added tax is that it is neutral as between factors of production, relative to existing business taxes, it strongly favors capital intensive industries over labor intensive industries. This could have serious implications on the State's ability to attract and maintain labor-intensive industries and on the general employment situation.

COMPARISON OF VALUE-ADDED TAX DUE (0.9879% RATE) WITH CORPORATE BUSINESS TAXES PAID IN 1968

Corporation	Type of Operation	Corporation Business Taxes Paid In 1968	New Jersey Allocated Value Added	Tax Due If .9879% Of Value Added
A	Distributor	$ 18,364	$ 1,596	$ 15,766
B	Manufacturer & Distributor	17,466	1,576	15,569
C	Manufacturer	41,350	5,818	57,476
D	Retailer	117,588	26,442	261,220
E	Manufacturer & Distributor	9,111	359	3,546
F	Manufacturer & Sales	14,734	465	4,593
G	Manufacturer, Distributor & Sales	499,504	34,288	338,731
H	Manufacturer & Sales	68,806	9,022	89,128
	TOTALS	$786,928	$79,566	$786,029

Moreover if the assumption about the shifting and incidence of the corporate income tax is changed to an assumption that the corporate income tax is shifted to consumers of products produced by the corporate sector in the form of higher prices, the overall effect of the value-added tax is altered. Some economists have pointed out that oligopolistic market structures dominate ecónomic activity, and many firms seek a "satisfactory" rate of return rather than aiming specifically at the maximization of profits. Such firms regard normal or expected returned on capital as elements of cost and will set prices to cover corporate income tax costs along with other costs. Therefore, the burden of the corporate income tax is reflected in higher prices to consumers and not in lower dividends and stock prices to holders of securities. In this instance, the substitution of value-added taxation simply means an increase in the prices of all goods and services as contrasted to a levy which raises the price of goods produced by the corporate sector only.

The Committee concludes that:

1. The advantages of a value-added tax are more appropriate for a national economy as a whole rather than for an individual state. Out of state purchasers and sales at the various stages of production would greatly undercut the assumption that the tax will be passed on to the ultimate consumer. This may place various producers at a competitive disadvantage.

2. The value-added tax is merely a series of sales taxes. Like the sales tax it is regressive, but its regressivity is not as easy to correct as a sales tax. While the tax on the final consumer is not as visible, this is not regarded as an advantage. This also creates problems of deductibility under the federal income tax. The objective of improving our present sales tax is deemed more important than adding another sales tax.

3. The value-added tax bears equally on the profitable and unprofitable firm and may discourage new industrial development.

4. Although the value-added tax may have certain administrative advantages, the problems of administration of the sales tax are not sufficient to necessitate its replacements.

5. While the value-added tax is more neutral as to the form of organization than the corporate business tax, this factor must be evaluated in light of all business

taxes. Experience in the State has not demonstrated that the tax structure has shifted business activity away from the corporate sector.

6. In light of recent announcements, it is likely that the value-added tax will be preempted by the federal government. Accordingly, it would be unwise at this time to propose a tax structure built on such an uncertain future.

7. Accordingly, a value-added tax should not be considered as a potential source of revenue for the State, or as a possible component of a balanced tax structure.

SECTION C — TAXATION OF INDIVIDUALS

Chapter X

New Jersey Death Taxes

The Committee has reviewed the New Jersey death tax structure and has concluded to recommend maintenance of the present Transfer Inheritance Tax.

Five principal changes are suggested:

1. Increase to $20,000 the present exemption of $5,000 which has been in effect since 1914 on transfers to spouse, issue, parents, etc. (Class A beneficiaries);

2. Impose a flat 5% tax rate on transfers in excess of $5,000 to non-educational charities;

3. Eliminate the present exemption on non-homestead property held as joint tenancies by the entirety;

4. Establish a more equitable tax on qualified pension and profit-sharing plans by taxing those assets only to the extent of the percentage of the decedent's contributions to fund such benefits. This procedure conforms with the treatment of these assets for Federal Estate Tax purposes; and

5. Tax life insurance proceeds to named beneficiaries, including inter-vivos trustees, to the extent that such proceeds exceed:

a. $50,000 paid directly to the Decedent's surviving spouse; plus

b. An additional $10,000 for payments in excess of $50,000 to the Decedent's surviving spouse for each surviving minor child of the Decedent who lives with his or her surviving spouse; plus

c. $10,000 for each Class A beneficiary other than the Decedent's surviving spouse.

Estate vs. Inheritance Tax

The estate tax, currently employed by eight States and the Federal Government, is levied on the value of the entire estate in accordance with a single rate schedule. Rate schedules are usually graduated, with larger estates being more heavily taxed. The amount of tax is determined by multiplying the value of the taxable estate by the appropriate rate. This single tax, imposed without regard to the identity of the beneficiaries selected by a decedent in his will or the amount these beneficiaries are to receive, has the advantage of simplicity and efficiency, hence understanding.

The inheritance tax, currently used by 38 States and the District of Columbia, is imposed not on the estate as a whole but on the value of transfers to different classes of beneficiaries. By using separate rate schedules (Table 5-16) which tax transfers to non-relatives (Class D beneficiaries) or collateral relatives, e.g., brothers, sisters, aunts and uncles (Class C beneficiaries), more heavily than transfers to spouses, parents or children (Class A beneficiaries), the State has sought to alleviate the burden of death taxation on the closest relatives of the Deceased. To compute the tax, one must total the amount to be received by each beneficiary, subtract the appropriate exemption, and multiply the remainders by rates found through consulting the separate rate schedules. The simplicity of a single computation is thus sacrificed in favor of lessening the tax burden on transfers to the immediate family. The Committee is particularly concerned with protecting surviving widows where the primary family wage-earner has died prematurely.

Achieving tax equity through the use of an inheritance tax is demonstrated by Table 5-17, Relationship of Valuations and Taxes in Various Beneficiary Classifications—1970. Although distributions to collateral kindred and non-relatives amounted to 19.3% by value of total distributions of estates, they accounted for 52% of all inheritance taxes. Distributions to the immediate family, however, while valued at 64.9% of the total, accounted for only 35.3% of the taxes. For small estates under $60,000, where high taxes are most likely to jeopardize the family financial stability, the results were even more dramatic, due to the lower rate on small transfers, often by intestate distributions, to the immediate family. From such estates distributions to Class A beneficiaries were 77.4% by value of total distributions. Yet the taxes imposed thereon represented only 20.7% of the total taxes collected. Bequests to non-relatives, on the other hand, provided only 10.8% of the total value and yet accounted for 47% of the taxes collected from such estates worth less than $60,000. The favorable tax treatment of these estates is an important aspect in evaluating the equity of an inheritance tax. Table 5-18, Taxable Estates by Valuation, Number and Tax, shows that this group consistently accounts for 80 to 85% of the number of estates probated and approximately one-fifth of the taxes.

TABLE 5-16

PRESENT NEW JERSEY INHERITANCE TAX RATES

Block of Net Taxable Transfer Less Exemption	Class "A"	Class "B"	Class "C"	Class "D"	Class "E"
$ 15,000	1		11	15	
35,000 (50,000)	2		11	15	
50,000 (100,000)	3		11	15	
50,000 (150,000)	4		11	15	
50,000 (200,000)	5		11	15	
100,000 (300,000)	6		11	15	
200,000 (500,000)	7		11	15	
200,000 (700,000)	8	See	11	15	See
200,000 (900,000)	9	Footnote	11	16	Footnote
200,000 (1,100,000)	10	Class "B"	11	16	Class "E"
300,000 (1,400,000)	11		13	16	
300,000 (1,700,000)	12		14	16	
500,000 (2,200,000)	13		15	16	
500,000 (2,700,000)	14		16	16	
500,000 (3,200,000)	15		16	16	
500,000 (3,700,000)	16		16	16	
Over $3,700,000	16		16	16	

Class "A"—Father, mother, husband, wife, child, issue, et al. $5,000 exemption from first block.

Class "B"—Churches, hospitals, religious, charitable and benevolent organizations and purposes. $5,000 exemption, 5% on amount in excess of exemption. Eliminated June 30, 1963, C.61, Laws 1962. Now completely exempt.

Class "C"—Brother, sister, wife or widow of son of decedent, or husband or widower of a daughter. Less than $500 no tax; $500 or more no exemption.

Class "D"—Every other transferee. Less than $500 no tax; $500 or more no exemption.

Class "E"—State and political subdivisions thereof; churches, hospitals, charitable and religious organizations, etc., exempt.

In deciding to recommend retention of an inheritance tax, the Committee placed great emphasis on protecting the immediate family of decedents and in so doing recognized that a change to an estate tax would cause the tax burden to fall more heavily on the immediate family of a decedent. It is also difficult to establish estate tax rate schedules which would maintain the current considerable yield of the inheritance tax—$65 million in 1970 as shown on Column 5 of Table 5-19—while not imposing a harsh burden on the very beneficiaries the inheritance tax favors. New Jersey has traditionally relied heavily on the death tax as a source of revenue; in 1960 and 1970 its ranking was second among the States in percentage of total State revenue obtained by death taxation and fourth among the States in total dollars realized from the imposition of death taxes.

The Committee constructed an estate tax, designed to maintain the current yield, whose rates ranged from 1% to the existing inheritance tax top rate of 16%. Table 5-20 demonstrates that such a tax drastically increases the burden borne by the spouse and children throughout the entire range of estate valuations.

Two suggestions which would moderate this unacceptable result appear likewise unacceptable. The first one, a decrease in the tax rates, would result in a lower tax yield. The second, use of a steeply graduated rate schedule with low rates on smaller estates, would require extremely high rates for the small number of larger estates if revenue production is to be maintained. Such rates would be unfair, in view of the highly graduated nature of the Federal Estate Tax, and would probably be less productive than expected, for citizens of such means are precisely those who can most easily afford to establish domicile in other States in order to minimize their death tax liability. Many professionals in the field of estate planning have argued that New Jersey death tax statutes already encourage such changes in domicile.

One circumstance compels the Committee to qualify somewhat its support of the current mode of death taxation. For the past ten years, the United States Congress has considered proposals to increase significantly the credit allowed by the Federal Estate Tax for monies collected pursuant to a State estate tax. Under such proposals, monies collected by States would not be in addition to the Federal Estate Taxes, but would be substituted for part of them. Table 4 reveals the revenue effect to the State of New Jersey were it to benefit from an estate tax credit of 40% of the

TABLE 5-17
State of New Jersey
RELATIONSHIP OF VALUATIONS AND TAXES IN VARIOUS BENEFICIARY CLASSIFICATIONS—1970

Estate Size Groups	Class "A"				Class "C"				Class "D"				Exempt		Compromise			
	Value	%	Tax	%	Value	%	Tax	%	Value	%	Tax	%	Value	%	Value	%	Tax	%
0-60,000 .... (17,767 estates)	281,972,496	77.4	2,681,247	20.7	37,838,742	10.4	4,014,380	31.0	39,531,635	10.8	6,097,585	47.0	2,212,825	00.6	2,883,138	00.8	168,301	01.3
60,000-100,000 ...... (1,656 estates)	92,604,720	76.7	1,578,263	29.8	16,389,588	13.1	1,138,361	21.	16,462,599	13.1	2,456,255	46.4	1,553,302	01.2	—	—	116,842	02.2
0-100,000 .... (19,423 estates)	374,577,216	76.4	4,259,510	23.3	54,228,330	11.1	5,152,741	28.2	55,994,234	11.4	8,553,840	46.3	3,766,127	00.7	1,501,341	00.3	283,143	01.5
All Categories .... (21,415 estates)	772,361,521	64.9	20,846,131	35.0	95,866,786	8.1	9,897,579	16.8	133,944,785	11.2	20,788,719	35.2	34,087,132	02.9	153,423,185	12.8	7,461,605	12.7

TABLE 5-18
State of New Jersey
TAXABLE ESTATES BY VALUATION, NUMBER AND TAX—1962, 1967, 1970

Size Group	Net Estate (millions)			% of Totals			Number of Estates			% of Totals			Assessments (thousands)			% of Totals		
	1962	1967	1970	1962	1967	1970	1962	1967	1970	1962	1967	1970	1962[1]	1967	1970	1962	1967	1970
Under $60,000	$211.2	$289.6	$ 364.4	32.3	30.3	30.6	12,298	14,906	17,767	85.8	82.6	83.0	$ 4,683	$10,221	$12,962	21.4	22.9	22.0
60,000- 100,000	65.8	100.8	125.6	9.8	10.5	10.6	857	1,296	1,656	6.0	7.2	7.7	1,664	4,226	5,290	7.6	9.6	9.0
100,000- 150,000	52.0	82.5	90.6	7.7	8.6	7.6	431	682	742	3.0	3.8	3.5	1,391	3,587	4,098	6.3	8.0	7.0
150,000- 200,000	39.9	61.6	64.5	5.9	6.4	5.4	229	361	371	1.6	2.0	1.7	1,095	2,931	3,340	5.0	6.6	5.7
200,000- 300,000	53.8	83.9	86.6	8.0	8.8	7.2	213	337	358	1.5	1.9	1.6	1,642	3,821	4,273	7.5	8.6	7.2
300,000- 500,000	56.8	96.8	89.2	8.4	10.1	7.5	148	247	234	1.0	1.4	1.1	1,857	4,725	5,019	8.5	10.6	8.5
500,000- 700,000	36.2	46.2	67.0	5.4	4.8	5.6	60	79	115	0.4	0.4	0.5	1,314	2,350	3,799	6.0	5.3	6.4
700,000- 900,000	28.9	26.1	52.8	43	2.7	4.4	37	33	63	0.3	0.2	0.3	1,258	1,378	3,060	5.7	3.1	5.2
900,000-1,000,000	7.6	15.8		1.1	1.7		8	16		0.06	0.09		291	739		1.3	1.7	
1,000,000-1,200,000	11.8	24.0	23.2	1.8	2.5	1.9	11	22	21	0.08	0.12	0.1	533	1,530	1,175	2.4	3.4	2.0
1,200,000-1,500,000	16.3	20.1	29.4	2.5	2.1	2.5	12	15	22	0.08	0.09	0.1	682	1,313	2,750	3.2	2.9	4.7
1,500,000-2,000,000	23.5	24.6	39.7	3.5	2.5	3.3	13	14	23	0.1	0.08	0.1	1,124	1,995	2,132	5.2	4.5	3.6
2,000,000-3,000,000	21.6*	34.7*	50.0	3.2*	3.6*	4.2	9*	14*	21	0.06*	0.09*	0.1	1,166*	2,690*	2,851	5.0*	6.1*	4.8
3,000,000-4,000,000	6.8*	8.1*	30.8	1.0*	0.9*	2.6	2*	3*	9	0.01*	0.02*	0.04	361*	535*	1,895	2.0*	1.2*	3.2
4,000,000-5,000,000	12.7	13.9	22.2	1.9	1.5	1.9	3	3	5	0.02	0.02	0.02	1,008	1,159	1,676	4.6	2.6	2.8
Over 5,000,000	28.9	27.7	53.7	4.3	2.9	4.5	5	3	8	0.04	0.02	0.04	1,883	1,420	4,678	8.6	3.2	7.9
TOTALS	$673.8	$956.3	$1,189.7	100	100	100	14,336	18,031	21,415	100	100	100	$21,952	$44,620	$58,998	100	100	100

[1] Rate change effective March 29, 1962
* Estimated

TABLE 5-19

FEDERAL ESTATE AND GIFT TAX COLLECTIONS IN NEW JERSEY AND ESTIMATED YIELD OF 40-PERCENT CREDIT, 1960 - 1970

($ THOUSANDS)

Year	Federal Collections in New Jersey (000) Estate Tax* (1)	Gift Tax (2)	Total (3)	Revised Federal Estate Tax Credit (40-percent of Column 1) (4)	New Jersey Death Tax Collections (5)
1970	$119,611	$15,674	$135,285	$47,844	$65,574
1969	141,636	13,643	155,279	56,654	63,447
1968	110,909	14,243	125,152	44,364	55,358
1967	109,751	8,590	118,341	43,900	54,498
1966	103,681	6,025	109,706	41,472	52,775
1965	92,395	5,774	98,169	36,958	48,197
1964	83,588	4,385	87,973	33,435	47,656
1963	81,669	4,350	86,019	32,668	40,115
1962	69,546	7,792	77,338	27,818	24,059
1961	90,402	4,556	94,958	36,161	24,676
1960	52,857	4,224	57,081	21,143	20,621

* Net after credit for state death taxes.

TABLE 5-20

State of New Jersey

COMPARISON OF INHERITANCE AND ESTATE TAXES ON VARIOUS SIZE ESTATES

(Present Class "A" Exemptions for Both Taxes)

NET ESTATE	ESTATE TAX	INHERITANCE TAX All to Wife	½ to Wife ½ to 2 Children	Equally to 2 Children	Equally to 2 Brothers	Equally to Non-relatives
$ 20,000	$ 300	$ 200	$ 50	$ 100	$ 2,200	$ 3,000
30,000	600	400	150	200	3,300	4,500
40,000	1,000	600	300	400	4,400	6,000
50,000	1,500	800	450	600	5,500	7,500
60,000	2,100	1,100	600	800	6,600	9,000
100,000	4,500	2,300	1,400	1,600	11,000	15,000
200,000	11,500	6,800	3,900	4,600	22,000	30,000
300,000	19,500	12,800	7,400	8,600	33,000	45,000
400,000	27,500	19,800	11,400	13,600	44,000	60,000
500,000	36,500	26,800	16,400	19,600	55,000	75,000
750,000	60,500	47,300	30,400	36,100	82,500	113,000
1,000,000	87,500	70,800	46,400	53,600	110,000	153,000
1,500,000	151,500	125,800	83,400	94,600	174,000	233,000
2,000,000	222,500	188,800	124,400	141,600	250,000	313,000
2,500,000	297,500	256,800	170,900	194,600	330,000	393,000
3,000,000	377,500	329,800	220,400	251,600	410,000	473,000
3,500,000	457,500	407,800	273,400	312,600	490,000	553,000
4,000,000	537,500	487,800	330,400	377,600	570,000	633,000
4,500,000	617,500	567,800	388,900	433,600	650,000	713,000
5,000,000	697,500	647,800	451,400	513,600	730,000	793,000
8,000,000	1,177,500	1,127,800	865,400	975,600	1,210,000	1,273,000
10,000,000	1,497,500	1,447,880	1,161,400	1,295,600	1,530,000	1,593,000

Federal Estate Tax. These sums, in contrast with the inheritance tax, would represent no extra burden on New Jersey taxpayers, but would instead divert to the State Treasury monies which otherwise would go to Washington. It might prove beneficial for New Jersey to take advantage of such a credit and adopt an estate tax were the credit enacted into law. Loss in revenue resulting from a gap between the amount derived from an estate tax keyed to the credit and that which would be obtained from the present inheritance tax could be prevented, either by retention of the inheritance tax at lower rates or by enactment of an estate tax whose yield exceeded the federal credit.

It should be noted that use of an estate tax to capture a federal credit would not represent a policy departure for New Jersey. At present, New Jersey has a pick-up estate tax which captures the amount of the existing federal credit for state death taxes whenever the New Jersey inheritance tax does not equal the full amount of the credit. Extension of this estate tax should, however, await Congressional action.

The Committee recommends:

Retention of the present transfer inheritance tax as opposed to a federal-type estate tax.

Gift Tax

While its deliberations on death taxation have led the Committee to consider a gift tax for New Jersey, it does not recommend the adoption of such a tax. Although the Committee recognizes that equitable considerations favor the taxation of *inter vivos* gifts, since this method of disposing of one's property may be employed to avoid death taxes imposed upon the testamentary disposition of property, the implementation of a tax on *inter vivos* gifts would demand such an intricate set of laws, rules, regulations, auditing procedures and schedules in order to ensure uniform compliance and equitable enforcement that a large administrative division would be required. Of the 13 states which now impose a gift tax in conjunction with their death tax, only California derives significant revenue from this source and even in that State gift tax collections in 1970 were less than 8% of inheritance tax collections. Of those four states which exceed the 8% figure, only two, Minnesota and Wisconsin, received over $2 million from their gift taxes in 1970.

The Committee recommends:

The anticipated yield from a gift tax is small and does not justify creating the problems and costs that its administration would entail. Gifts made more than 3 years prior to death should be deemed not made in contemplation of death.

$20,000 Exemption For Class "A" Beneficiaries

The first act in New Jersey taxing transfers at death to husband, wife, children, issue and other closely related beneficiaries was adopted on March 26, 1914 (C. 57, Laws 1914). An exemption of $5,000 was provided for each beneficiary in this classification. Fifty-seven years later, the exemption remains at $5,000. The change in purchasing power of the dollar alone is sufficient reason to justify an increase in such exemption. It is, therefore, recommended that the exemption for Class "A" beneficiaries be increased from $5,000 to $20,000, even though such exemption increase will obviously result in decreased Transfer Inheritance Tax revenues.

Tenancies by the Entirety

The transfer occurring at the death of one of the tenants under a joint tenancy in either real or personal property has always been deemed subject to inheritance taxation subject to proof of the ownership by surviving joint tenants. However, the passing of real property held by husband and wife as tenants by the entirety has always been exempt from tax, whether the property was held for residential or investment purposes.

The rationale for the special treatment of tenancies by the entirety is the fear that the death tax on the primary family home could be heavy enough to force the surviving spouse to sell the home in order to pay the tax. Considering the limited exemption for the surviving spouse, the depressed financial condition of many elderly couples, and the progressive and heavy Federal and State death tax rates, the exemption for the transfer of homestead property held by the entirety is justified. However, the inclusion of non-residential properties in the exemption has provided for the tax-free transfer of large holdings of investment and business properties owned jointly by spouses upon the death of the first joint owner. These transfers do not merit the special tax consideration given to the primary family residence. The Committee believes that the policy of homestead protection should not apply to business properties.

Thirty-seven States and the Federal Government fully or partially tax the transfer to the survivor of title to real property held by husband and wife, several, incidentally, because the tenancy by the entirety is not recognized, so that title to real property held by husband and wife, with right of survivorship, is treated simply as a joint tenancy and taxed the same as all other joint tenancies. Massachusetts and Virginia statutes limit the exemption of such transfers of title to a single family residential property if the Decedent resides therein.

No statistics are available on which to base a sound estimate of tax yield from this potential source. It has been suggested that the yield might be $2.2 million annually. However, equity supports the desirability of taxing non-residential real property passing between spouses by right of survivorship.

The Committee recommends:

To limit the preference given to tenancies by the entirety to those situations where tax relief is needed, the Committee recommends that the transfer of title to all real property held by tenancy by the entirety be subject to tax except:

1. The principal or domiciliary single family residence of the Decedent, with the proviso that the land area to be included in the exemption shall be limited to that reasonably necessary to the full and fair enjoyment thereof, so as to preclude the inclusion of large acreage holdings in the case of rural homesteads;

2. That portion of a multi-family residential property, not exceeding four residential units, actually occupied by the Decedent as his principal or domiciliary family residence.

With regard to residential property held as tenancies by the entirety, that portion originally belonging to the survivor should naturally continue to be exempt from taxation.

It is noted in the interest of consistency and equity that enactment of a personal income tax statute in New Jersey, with capital gains treatment parallel to the Federal treatment, strongly suggests that executors and administrators be required to treat jointly owned property in the same manner on the Federal Estate Tax Return as on the New Jersey Transfer Inheritance Tax Return.

Life Insurance

Life insurance proceeds payable to the estate of the insured or to his executor, administrator or trustee under a trust created by will are currently taxable in New Jersey. Such proceeds when payable to the trustee of a trust created during the lifetime of the insured and then over to a beneficiary under the terms of such a trust, or to a designated beneficiary under the policy are not taxable. Thus, most life insurance proceeds presently escape taxation in New Jersey.

Twenty-eight States exempt life insurance proceeds payable to designated beneficiaries. While 15 other States tax designated beneficiary life insurance proceeds, most of them do so only after allowance of very substantial exemptions:

State	*Exemption*
California	$ 50,000
Colorado	75,000
Minnesota	20,000
Mississippi*	20,000
Montana	50,000
New York*	100,000
North Carolina	$20,000
North Dakota	25,000
Oklahoma	20,000
Oregon	75,000
Rhode Island	50,000
Tennessee	40,000
Texas	40,000
Washington	40,000
Wisconsin	10,000

*Estate tax law.

In addition to these 15 states, there are an additional six states with "pickup" or estate tax laws designed to absorb the Federal Estate Tax credit thereby indirectly taxing designated beneficiary life insurance since the Federal act extends to such insurance where incidents of ownership of the policy are retained by the insured decedent.

The pattern, both in New Jersey and other States, indicates that legislatures have considered insurance proceeds to be different from other assets in an estate. This difference is based upon the conclusion that life insurance is purchased for purposes of protection, rather than investment. To the extent that insurance is employed by people of moderate means as a device to ward off unforeseen misfortune, the Committee believes it should continue to receive special tax treatment.

There are also valid reasons for taxing life insurance proceeds. Insurance policies have a cash surrender or a loan value; in this respect they resemble other taxable assets which may be liquidated or pledged. Thus, there is a powerful argument on equitable grounds for subjecting them to inheritance taxation. The creation of a dollar exemption can be used to give recognition to the unique role of insurance in providing a basic sum for protection. Beyond this exemption life insurance proceeds should be treated as any other asset would be treated for inheritance tax purposes. These opposing considerations led the Committee to conclude that life insurance proceeds should be taxed on a limited basis.

The Committee recommends:

Life insurance proceeds should be included in the inheritance tax base to the extent that they exceed:

1. $50,000 paid directly to the Decedent's surviving spouse; plus

2. An additional $10,000 for payments in excess of $50,000 to the Decedent's surviving spouse for each surviving minor child of the Decedent who lives with his or her surviving spouse; plus

3. $10,000 for each Class A beneficiary other than the Decedent's surviving spouse.

Although the Committee believes that greater emphasis should be placed on the payment of premiums as a means of determining policy ownership and therefore the inclusion of such proceeds in the inheritance tax base, administrative simplicity dictates that New Jersey inclusion standards substantially conform to the Federal "incidents of ownership" test which classifies the payment of premiums as merely one of several criteria.

The Committee recommends:

The abolition of the current distinction between life insurance proceeds payable to testamentary trustees (taxable) and life insurance proceeds payable to inter-vivos trustees (not taxable).

This distinction resulted from attempts to limit two statutes, now N.J.S.A. 54:34-4(b) and 4(f), which were enacted to restrict court rulings which expanded the taxability of insurance proceeds. *Estate of R. Gemmell,* 123 N.J. Eq. 315 (Prerog. Ct. 1938); *Fagan v. Bugbee,* 105 N.J.L. 85 (Sup. Ct. 1938). This distinction has no economic or other basis and should not be retained. The Committee recommends that its proposal as to the taxation of life insurance proceeds be applied uniformly to all life insurance policies.

Pension, Stock Bonus and Profit-sharing Plans

In essence, the same basic policy issues considered in connection with life insurance proceeds are also involved with pension, stock bonus and profit-sharing plan benefits. New Jersey now fully taxes such benefits with very limited exceptions.

The Committee recommends:

In the interest of a more equitable approach, that these assets be included only to the extent of the Decedent's contributions to the funding thereof. This practice would follow the treatment accorded by the Federal Estate Tax statutes.

Transfers to Charitable, Educational, Benevolent, etc., Organizations

Before 1922, transfers to charitable organizations were exempt from inheritance taxation. In that year, Chapter 174, Laws of 1922 imposed a 5% levy on all such transfers of $500 or more. During the following years the Legislature enacted exceptions to the taxation of charitable bequests, most notably in the area of bequests to non-profit educational institutions. In 1962, C. 61, L. 1962 restored the complete exemption for bequests to charitable organizations, thus reinstating the conditions which existed prior to 1922.

In its review of the exemption for charitable transfers, the Committee has been sensitive to the social contributions of these benevolent organizations. It concludes, even so, that equity requires these organizations to bear some of the burden of inheritance taxation. If bequests to widows, children and others who are deserving of consideration are taxed, it seems only fair to extend the tax base to charitable organizations. The Committee believes that a bequest to a non-profit organization is not significantly more worthwhile than a bequest to a widow, thus warranting much more favorable treatment. Rather, the two types of bequests should receive comparable inheritance tax treatment.

The Committee's inclination to impose a modest tax on charitable transfers has been influenced somewhat by the problems which might arise from the tax treatment of such transfers by other States. Most States exempt transfers to out-of-State charities only if the State in which the charity is located itself imposes no tax on charitable bequests to out-of-State beneficiaries. If New Jersey were to tax bequests to charitable organizations located both within and without its borders, other States might retaliate by taxing bequests made by their decedents to New Jersey charities. As a result, the inflow of monies from other States to New Jersey charities could be imperiled. The disadvantage of giving to groups within this State would be particularly obvious to citizens of other States since at present no other States tax charitable transfers, and thus, only bequests to New Jersey charities would be subject to retaliatory taxation.

One possible solution to the problem would be to exempt bequests made to out-of-State charities, but this would be undesirable because it would encourage local residents to bequeath monies to non-New Jersey charities. Instead, the Committee has decided to recommend exemption from taxation for all testamentary transfers to non-profit educational organizations. Other types of charitable organizations, e.g., churches or hospitals, receive relatively few bequests from out-of-state decedents and would not be endangered by a diminution of contributions resulting from retaliatory taxation. Private educational institutions, on the other hand, are extremely dependent on the flow of contributions from out-of-State alumni and would be placed in a vulnerable position if other States decided to tax contributions to institutions which are located in New Jersey, but not elsewhere.

The Committee recommends:

That transfers to non-educational charitable, benevolent, etc., organizations, with the exception of non-profit educational institutions, be taxed at the flat rate of 5% to the extent that these transfers exceed $5,000. The 5% rate and the $5,000 were in effect prior to 1962 and strike a fair balance between the State's desire to encourage charitable giving and the equitable policy of imposing some tax on such transfers. Although there are few facts on which to estimate with precision the yield of this tax, it seems probable that it would produce approximately $1.5 million.

Tax Rates and Valuation Brackets

Consideration was given to increasing or decreasing the tax rates in one or more of the beneficiary classifications. In view of the very substantial rate increases in 1962, ostensibly to assist victims of the 1962 coastal storm, especially in Classes "C" and "D", and the fact that death taxes in New Jersey are already heavy when compared with those in other States, it was concluded that there should be no change in any of the rates.

Valuation Problems

A. **Listed or Frequently Traded Securities**

Proposal: When a person dies on a weekend, holiday, or any other day on which stock in his estate is not traded, the valuation of the stock should be a weighted average between the means of the high and low prices for the security on the last trading day before and the first trading day after his death. However, both such trading days must be within a reasonable time of the valuation date. The weight to be given to the mean of a particular day shall be inversely proportional to its distance in terms of market days from the date of death. If death occurs during a weekend, the value of the stock should be an exact average of the Friday and Monday means since these days are an equidistant number of market days away from the weekend. If, however, the same decedent's security was not traded on Friday although the market was open, the value should be computed by giving double weight to the Monday mean as compared with the Thursday mean.

If no sales occur within a reasonable time before or after death, the mean of bona fide bid and asked prices on the valuation date, or if there were no offers on that day, a weighted average similar to the one described above should be employed to value the stock.

If there were no bid and asked prices a reasonable time before the valuation date, then a mean of the sales prices or bid and asked prices a reasonable time after death shall provide the value—conversely, if there were no trading a reasonable time after the valuation date.

In cases where these averages or means are determined not to reflect fair market value, as where sales are few or sporadic, a control block of stock is involved, or the block is so large it could not have been sold on the market without depressing it, reasonable modifications of the averages should be employed provided that full supporting data is given.

These changes would bring New Jersey valuation practices, as currently embodied in Reg. 18:26-103, in line with Federal I.R.C. Reg. 20:2031.2. The present New Jersey regulation utilizes only a mean of the last trading day prior to death if death occurs on a weekend or legal holiday. It does not specify procedures for dealing with securities which were not traded on a death date for reasons other than the closing of the securities market. No new legislation would be needed to accomplish these changes.

B. **Closely Held Securities**

Executors and administrators should not be forced to contend with different State and Federal methods of valuing closely held securities. Yet, this circumstance can arise under current law. The separate valuations do not usually result from basic policy differences for the Federal and State regulations set forth similar guidelines for valuing closely held stock. Compare I.R.C. Reg. 20.2031-2(f) with N.J. Inheritance Tax Bureau Reg. 18:26-101. However, application of the possible bases for determining value depends on the judgment of the appraiser and on occasion two equally competent appraisers may evaluate closely held stock differently by giving more or less weight to book value, dividend-paying capacity, performance of similar companies, or any of the other possible standards. When this happens, the State official charged by N.J.S.A. 56:34-5 and 9 with the duty of making an independent evaluation is under no obligation to reconcile or conform his estimate with one made by a Federal agent:

> The federal finding is on this record merely another expression of expert opinion and the state bureau is not obliged to give it greater weight than other expert opinion before it. *Tracy v. Alexander,* 17 N.J. 397, 406 (1955).

The Committee recommends:

To obviate the burden placed on taxpayers who must confer separately with each of two agencies over the valuation of closely held stock, the Committee recommends amendment of 56:34-9 to require the state appraiser to follow the valuation given by the I.R.S. unless there is some clear reason for not doing so.

This recommendation will not eliminate one further difference between New Jersey and Federal valuation of closely held stock. If a stock is subject to a binding, arms-length purchase agreement operative at death, the Federal authorities will usually accept the contract price in determining the value of the stock to the estate, I.R.C. Reg. 20.2031-2(H). New Jersey, on the other hand, requires appraisal at actual market value at time of death even where the contract price was determined by arms-length bargaining. While the Federal (and New York) rule is proper for an estate tax since the value of the stock to an estate is only what the estate can obtain for the stock under the sales contract, New Jersey with its inheritance tax is concerned with the value of the stock in the hands of a transferee, i.e., what the property is worth to the person succeeding to it. For that reason, New Jersey should continue to base its tax on the actual market value of the stock. See *Schroeder v. Zink,* 4 N.J. 1, 13-14 (1950). Since the differing weight accorded to sales agreements is based on the nature of the tax, estate versus inheritance, different Federal and State appraisals must still be tolerated where such an agreement is involved.

Alternate Valuation Date

The absence of an alternate valuation standard where there is a sharp decline in the economy may pose a hardship for many estates.

The Committee recommends:

That the inheritance tax law be amended to provide for the use of an alternate valuation date six months after the date of decedent's death, as is provided in the Federal Estate Tax laws.

If New Jersey adopts a personal income tax statute which contains capital gains provisions similar to the Federal statutes, executors should be required to select the same valuation date for New Jersey inheritance tax purposes as for Federal Estate Tax purposes, thus assuring that the cost basis of the property transferred is identical for New Jersey and Federal tax purposes.

Once the election is made for a valuation as of six months following the date of death, all estate assets should, as under the Federal statutes, be valued as of that date whether values of individual assets increase or decrease during the post-death period, except for property distributed, sold or otherwise disposed of which should be valued as of the date of disposition.

The Federal rules permitting the alternate date recognize the changing value of assets and allow the taxpayer his choice of valuation dates. Shrinkage in value of the assets during the six month period by no means assures that the taxpayer will automatically elect the date having the lower valuation. Establishment of a higher cost basis of an asset can sometimes be more advantageous to the taxpayer than a reduced death tax. In cases of violent shrinkage in asset value due to uninsured loss or other cause, the Federal procedure, however, is unquestionably more equitable to the taxpayer.

Previously Taxed Property

New Jersey presently taxes transfers at death without regard to previously taxed transfers, i.e., the fact that it may previously have been taxed a short time before in another estate. As an extreme example, if a father, mother and child should die successively within two weeks from injuries sustained in an automobile accident, property passing by will from father to mother to child will be taxed in New Jersey three times before it is acquired by any other beneficiary. Such successive taxation of a single piece of property is unjust. The intervening decedents—the mother and the child—never actually enjoyed the benefits of the property obtained from the father. In reality, only the one transfer from father to a third beneficiary, possibly another child, has taken place, but the inheritance tax, relying on technicality, finds three such transfers.

Under the Federal Estate Tax laws, a diminishing tax credit in the estate of the transferee obtains if his demise follows the death of the transferor within a ten-year period. A full tax credit is allowed if the transferee dies within two years after the death of the transferor.

Seventeen States, including New Jersey, make no provision for the special tax treatment of previously inherited property. Eight States provide a tax credit, but four of them limit the credit to transfers to closely related beneficiaries, i.e., husband, wife, issue, etc. Eleven States provide for a property exemption, five of these limiting the exemption to transfers to closely related beneficiaries. And 13 States with estate tax laws, several of the "pickup" variety, generally follow the Federal treatment.

Of the 19 inheritance tax States which allow either a tax credit or a property exemption, the periods between the death of the first and second decedents vary widely:

Period-Years	*Number of States*
2	4
3	2
4	1
5	10
6	1
10	1
	19

There is justification for special tax treatment of transfers of property where the deaths of the first and second decedents occur within a relatively brief period of time. The revenue loss cannot be estimated since it will depend primarily on the number of large estates (over the $100,000 valuation level) which may receive this special treatment in any fiscal year.

The Committee recommends:

The Transfer Inheritance Tax Act be amended to provide an exemption in the estate of a second decedent for property previously inherited and previously taxed when death occurs within a period of five years from the death of the first decedent, provided, however, that the amount of such credit shall not exceed the tax which would otherwise be imposed if there were no credit.

It is recommended that the Federal procedures for computing this credit be adopted, but that the following graduated schedule be applied:

Years Between Deaths of Transferor and Transferee	*% Credit*
0-1	100%
1-2	80%
2-3	60%
3-4	40%
4-5	20%
5 and over	-0-

Miscellaneous Recommendations

Four additional inheritance tax problems considered by the Committee merit brief discussion:

1. **Preliminary Application for Waivers of Inheritance Tax Liens.** The Committee discussed simplification of the application form (Form L-4) for waivers of the State inheritance tax lien prior to payment of the tax.

The waiver information which forms the basis for determining ultimate tax liability must disclose all assets in the estate which are subject to the tax. The present waiver form appears necessary to accomplish this objective. The Committee makes no recommendation for changes in such waiver form, acknowledging, however, that discretion should be exercised by the Division of Taxation to simplify the compliance burden for the taxpayer where circumstances warrant.

2. **Safe Deposit Boxes.** In connection with safe deposit boxes the regulations should be strengthened to minimize the opportunity for tax avoidance. The legal representatives of estates should be asked to declare whether, to their knowledge, any safe deposit box had been rented in the name of another individual, corporation or partnership, to which the Decedent had a right of access, and, if so, whether, to their knowledge, such box contained any property of the Decedent or any property in which the Decedent had an interest.

3. **Disclosure of Existence of Escrow Funds.** Because the State's inheritance tax lien on real property lasts ten years after death while the State's right to collect inheritance taxes endures for 20 years after one's death, a transfer of potentially taxable real estate made between 10 and 20 years after the death of the owner is usually accompanied by the establishment of an escrow fund for the payment of inheritance taxes. These escrow funds are held until 20 years after death, and, if not claimed by the State for taxes by the end of that period, are paid back to the parties involved in the transfer. As is the case with safe deposit boxes, there presently exists no requirement to reveal to the taxing authorities the existence of these funds or any other escrow funds and the transfers which prompted their establishment. The Committee recommends, therefore, that the inheritance tax laws be amended to require notice to the Division of Taxation of all real property transfers made between 10 and 20 years following the owner's death and whether or not an escrow fund was established in connection with the transfer.

4. **Interest and Penalty Rates; Interest on Refunds.** The present law requires a taxpayer to pay the inheritance tax within eight months of the Decedent's death and imposes an interest charge on amounts which are due, but not paid by that time. The interest rate is 10% or 6% depending on whether the delay in payment was justified, a distinction which should be clarified.

No countervailing provision has ever been made for the payment by the State of interest on overpayments of taxes. Since the State receives the benefit of interest, even where justifiable reason exists for late payment, it should be required to pay interest after the due date for filing where a taxpayer has paid an amount in excess of the final tax bill. The Committee therefore recommends that the State be required to pay interest on refunds of inheritance taxes at a rate of 6% on the excess funds held after the due date for filing the return.

A second issue involving interest has also been the subject of Committee discussion. In two situations, one involving powers of appointment and a second involving contingent remainders, the identiy of the beneficiary may not be known at the time of death and certainly the amount of the transfer cannot then be determined. The Legislature has provided a special procedure for such situations pursuant to which the executor can negotiate a compromise with the State and obtain a release of the bequests by paying the tax although it is not yet due. Payments made under the compromise provisions are not bound by the eight-month deadline and thus no interest is levied on the failure to reach a compromise or to make the payment within that time.

Too often, however, controversies arise as to whether property is covered by the compromise tax or whether it is covered by the direct tax and thus subject to the eight-month deadline and consequent interest payments. The Committee recommends, therefore, that the Division of Taxation clarify its rules concerning the distinction between interest-free compromisable bequests not subject to the payment deadline and non-compromisable interest-bearing bequests which are covered by it.

Chapter XI

The Sales and Use Tax

As the quest for additional revenues to support the cost of government continues, more states look to broad-based taxes, especially sales and use taxes, as indispensable components of an equitable tax system. Indeed, the sales tax is second only to the property tax as a major revenue producer for State and local governments.[1]

Currently, forty-five states levy retail sales taxes, and one additional state is planning to implement a sales tax shortly. During the 1971 sessions of State legislatures, four states increased sales tax rates, while six states broadened the sales tax base to cover additional purchases. However, the full potential of the sales tax has probably never been realized in any state. A combination of conflicting opinions about the categorization of the sales tax as a regressive/proportional/progressive form of taxation and wide variations in rate, imposition and exemption structures have prevented the implementation of an "ideal" sales tax anywhere in the nation.

In New Jersey, the sales tax, enacted only five years ago, already produces 40% of total State budgeted revenue. This level of revenue obtains notwithstanding New Jersey's comparatively low per family sales tax burden, which is a direct outgrowth of the extensive list of exemptions, including commodities and services such as food and medical care.

The New Jersey Taxpayers' Association has calculated that New Jersey ranks next to lowest among ten leading industrial states in terms of average sales tax burden, expressed as a percentage of income, for a family of four, (up to $15,000 annually), and third from lowest in the $20,000 category. Therefore, the consideration of tax issues before the Committee has included a deliberate and penetrating examination of the future role of the sales tax as a major component of New Jersey's total tax structure.

The Sales Tax in a Balanced Tax Structure

In considering whether the sales and use tax should be continued as part of the State tax structure, the short—and possibly final—answer is: there is no alternative. The tax is already the major revenue source for the State government and repeal would throw impossible burdens on other taxes.

Nonetheless, the Committee has considered the desirability of including the sales tax in the State-local structure, in light of criticisms often leveled at the tax. First, the sales tax is broad-based and as such is an acceptable revenue source. It has often been criticized as a regressive tax, but it need not be. Chapter 3 of this report has shown, in fact, that New Jersey's present tax is only slightly regressive. Zero regressivity may be unattainable but nevertheless the goal should be pursued vigorously through a rational system of exemptions. The tax can be elastic, responding to changes in personal income levels which have such a great effect on costs of government.

The sales tax must be viewed in the perspective of the entire tax structure, not as an isolated entity. As a tax on spending, it stands along with taxes on income and production as one of the major broad-based methods of raising government revenue. Modifications should be considered in light of the total tax picture, including enactment of a graduated income tax.

The Committee concludes:

That continuation of the sales and use tax is acceptable and essential, both to preserve a major source of revenue and to help insure that the citizens of New Jersey are taxed on as broad and equitable a base as possible.

The Rate

New Jersey's present sales and use tax rate of 5 per cent is generally in line with rates in nearby states. Yet, as previously mentioned, it ranks relatively low in per capita burden, due to a fairly wide range of exemptions. While many of these exemptions are designed to make the tax progressive, or at least less regressive, they have the effect of making the tax base narrower and less elastic. In 1970, the rate was raised from 3 to 5 per cent, to obtain badly needed revenue for the State. The tax's revenue, however, can also be increased by narrowing the range of exemptions, and where this can be

[1] Advisory Commission on Intergovernmental Relations, *State-Local Finances and Suggested Legislation,* December 1970.

done while making the tax more progressive, elastic and broader based, it is a preferable course.

The Committee recommends:

That the sales and use tax rate remain at 5 per cent and that any necessary increases in revenue produced be sought through broadening the tax base and decreasing its regressiveness.

Exemptions

To achieve the broadest possible base for the sales tax, spending for all goods and services should be taxed. The Committee shares the view of the Advisory Commission on Intergovernmental Relations, which, in describing the characteristics of a high-quality State-local tax system, observed that:

> "To insure productivity (of a sales tax), the tax base employed (should) cover most personal services as well as retail sale of tangible items."[2]

Exemptions from the sales tax narrow the tax base, causing those who remain covered by the tax to pay higher rates than they would otherwise. Exemptions should be granted only when they serve one of the following purposes:

1. Decrease regressivity;
2. Remove inequities;
3. Prevent harm to the economy;
4. Remove conflicts with other public policies; and
5. Remove administrative impracticalities.

The Committee has considered the exemptions presently in the New Jersey law and has found many which should be repealed, some which should be modified and some which should be kept. One previously abolished should be restored.

Clothing Exemption. One major exemption in the present law—clothing—was inserted with the laudable intention of making the tax more progressive. However, recent studies have indicated that the clothing exemption has the opposite effect.

As Jeffrey M. Schaefer has observed, ". . . including clothing in the tax base would increase the progressivity of the sales tax . . ."[3] Dr. Schaefer's study also presented a convincing case for removing the clothing exemption, and effectively dismissed earlier attitudes which led to its adoption.

It is noteworthy that the Connecticut State Revenue Task Force in its report submitted to the Governor and General Assembly on February 11, 1971 concluded that "the (clothing) exemption applies irrespective of the purchaser's financial ability. The buyer (of clothing) with a $60,000 income receives the same exemption designed for the person with a $3,000 income."

By way of further illustration of the inequitable nature of the clothing exemption, the Twelfth Report of the New Jersey Commission on State Tax Policy observed that "a two-hundred dollar suit of clothing is tax-exempt, but a two-dollar can of cleaning fluid is taxable."

The Twelfth Report also showed that the dollar value of the clothing exemption, on a per capita basis, is estimated to be more than twice as great for the $10-$15 thousand annual income category as for the $4-$5 thousand group.

The general acceptance of anti-clothing exemption arguments, such as those stated above, is demonstrated by the fact that only five states imposing sales taxes continue to exempt clothing sales, and each of these states sets forth conditions which impose the tax on certain clothing categories.

The Committee is persuaded by the evidence which clearly points to the inequitable, non-progressive nature of the clothing exemption, and views its removal from the Sales and Use Tax Act as a constructive step toward achieving tax equity.

To insure that elimination of the clothing exemption has minimum impact on low-income families, a system of providing appropriate rebates and/or tax credits can be devised. Such a credit or rebate system could be partially administered through the existing public welfare categorical assistance program in the form of increased monthly grants to cover the approximate value of sales tax paid for clothing purchases. For lower income families not covered by public assistance, a rebate system on a filed claim basis would be required. This could be handled by mail or perhaps through district offices of an existing State agency. It is estimated that a credit/rebate system would result in potential revenue reduction of $10 million of the $80 million first-year total revenue anticipated from the repeal of the clothing exemption.

The Committee recommends:

That the present clothing exemption be replaced by an income tax credit or rebate of $5.00 per capita, to each consumer unit having a total income of $1,300 per capita, or less.

Personal Services. A second major area of exemption is personal and professional services. The Committee can find no good reason for this exemption. It narrows the tax base without serving the goals of equity, public policy or practicality. It has a regressive effect on the sales tax structure. "Why tax the purchase of a washing machine while exempting a commercial

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[2] A.C.I.R., *State-Local Finances Suggested Legislation*, 1971 Edition.

[3] *Sales Tax Regressivity Under Alternative Tax Bases and Income Concepts*—Jeffrey M. Schaefer, National Tax Journal, December 1969.

laundry?" one authority asks.[4] It is an economic fact of life that consumer spending on services is increasing faster than spending on tangible goods. To omit this area of spending from sales taxation, for no good reason, imprudently and unfairly burdens purchases of tangible goods, and limits elasticity of the sales tax.

However, no sales or use tax should be imposed on professional services rendered by a physician, surgeon, dentist or other practitioner of medical arts and sciences. Due to the unpredictable nature of illness and injury, which may impose severe and unavoidable personal financial hardships, the imposition of a sales or use tax on medical services would be burdensome, probably regressive and socially harmful. For the same reason, the sales tax exemption for prescription drugs and medicines should be continued.

The Committee recommends:

The sales tax should be extended to all services, except public utilities, health services, beauty and barber shops, shoe repair and employment agencies.

A task force of the Committee has examined each exemption in the present sales tax law in light of the standards previously discussed. The exemptions and other features of the law as set forth in the Sales and Use Tax Act may be analyzed as follows:

Proposed Revisions of The Sales and Use Tax Act:

Section 2—Definitions . . .

Recommendation: Maintain—with modification

Certain minor changes are required in Section 2 to insure consistency with the recommended modifications of the Sales and Use Tax Act, as listed and discussed elsewhere in this report. These technical changes should be included in any legislation which may be proposed to implement the recommendations of this report.

Section 3—Imposition of Sales Tax

Existing Section 3(b) et seq. contains several provisions detailing the conditions under which the sales tax is imposed and details several exceptions[5] to this imposition.

The Committee, consistent with the general position previously outlined, suggests an amending substitution for this Section. However, for purposes of clarity, both the recommendation for amendment by substitution and the rationale for modifying provisions of existing Section 3(b) are included in the following discussion.

Section 3(b) et seq. The receipts from every sale, except for resale, of the following services . . .

Recommendation: Repeal—with substitution

The language of Section 3(b) in lieu of specific subsection amendments as recommended and discussed below and as identified as an alternate approach, might better be handled by simpler, all-inclusive language which clearly establishes the principle that *all* services expenditures are subject to sales tax imposition with only certain limited exceptions.

The exceptions would be restricted either to those items already covered by exemptions, as listed in Section 8, or to those items which present insurmountable obstacles both to administration and collection.

A revised Section 3(b), consistent with this premise, would read as follows:

> 3(b) The receipts from every sale, except for resale, of all services, professional or otherwise, excluding such retail sales as are excluded by definition in Section 2(e) of this Act, and further excluding:
> (1) Professional medical and health Services;
> (2) Personal services where administrative costs, as determined by the Director, would exceed revenue.
> (3) Beauty, barber and shoe repair shops and employment agencies.

It is estimated that revenues from imposition of the sales tax on expenditures for services would be $154.0 million as indicated in the following table:

Estimated Revenue Impact of Proposed Sales and Use Tax Extension to Services

Services:	Estimated Revenue
Laundry and Dry Cleaning	$ 12.8
Business, Management, Consulting	9.0
Statistical and Computer	2.3
Public Relations	.2
Interior Decorators	.2
Practice of Law	15.6
Practice of Architecture Engineering	12.0
Practice of Accounting	10.0
Construction	91.9
TOTAL	$154.0 million

3(b)et seq. Alternate Recommendations

The following group of recommendations on subsections of Section 3(b) are included in this report as feasible, but less desirable alternatives to a new section,

[4] *State and Local Sales Taxes,* Tax Foundation Inc., New York, New York, 1970, p. 23.

[5] N.B. The term "exception" appears in the discussion of Section 3, consistent with its use in the Sales and Use Tax Act. For all practical purposes, however, the term "exception" means the same as "exemption."

as discussed above, and also to outline the reasoning of the Committee with respect to the elimination, continuation and/or modification of existing provisions.

3(b)(2)(iv) **Any receipts from laundering, dry cleaning, tailoring, weaving, pressing, shoe repairing and shoe shining.**

Recommendation: Repeal—with partial substitution

The Committee in its attempt to broaden the sales tax base, views removal of this exception to the tax as reasonable and equitable. It is recognized, however, that obvious administrative difficulties may arise in the collection of a tax on a service such as shoe shining; therefore, this part of the exception should be retained. Appropriate administrative improvement should be initiated to collect sales taxes on the remaining affected services to hold revenue leakage to a minimum. Revenue potential is included in the $154.0 million anticipated from taxation of services discussed above.

3(b)(3) **Storing all tangible personal property . . .**

Recommendation: Maintain—with modification

The intent of this subsection should be expanded to include "cold storage of foodstuff and other commodities" to insure that charges for storage of property not held for resale are included in the tax base.

3(b)(4) **Maintaining, servicing and repairing real property.**

Recommendation: Repeal

The Committee feels that the exemption from the sales tax of services used in the maintenance and repair of real property should be repealed concurrently with its recommendation for the extension of the imposition of sales taxes on other services. The reductions in real property taxes recommended elsewhere in the Committee's report providing property tax relief is adequate reason for removing the exemptions under this Section.

3(c) **Receipts from the on-premises sale of food and drink except alcoholic beverages.**

Recommendation: Repeal

The Committee regards this subsection as redundant in terms of other recommendations contained in this report. It is the recommendation of the Committee that all sales of food and drink for on-premises consumption be taxed, notwithstanding the imposition of the excise tax on alcoholic beverages, as required by the Alcoholic Beverage Tax Law.

This action will eliminate one aspect of inequitable tax distribution, which was exemplified as follows in the Twelfth Report of the State Tax Policy Commission:

> "A twenty dollar bar check is tax exempt, but a two-dollar meal in the same room is taxable."[6]

The exception to the sales tax on food or drink sold to an airline for in-flight consumption contained in Subsection 3(c)(3) should be continued, but transferred to the appropriate provision of Section 8 of the Act, wherein exemptions are specified. Most scheduled airline service originating, terminating in, or traversing New Jersey involves interstate commerce. Therefore, insurmountable administrative obstacles prevent imposition and collection of an in-flight sales tax.

3(e)(1) **Any admission charge . . . in excess of $0.75 . . . except for charges to a patron . . . in which such patron is to be a participant . . .**

Recommendation: Repeal

The Committee concludes that all admissions should be subject to the sales tax, at the rates prescribed in Section 4 of the Act, to broaden the base of the tax. Furthermore, the existing exemption on participant admissions (e.g. to a bowling alley or swimming pool) should be removed to eliminate discriminatory imposition of the tax.

However, the existing exemption on admissions to functions of exempt organizations, as defined in Section 9(b)(1), should be continued. Revenue is included in the services estimated cited above.

3(e)(2) **The amount paid as charge of a roof garden cabaret . . .**

Recommendation: Repeal

This exception should be terminated, since it is redundant in terms of the recommended revocation of all admissions exceptions, as per 3(e)(1) above. Anticipated revenue is included in the services estimate shown above.

Section 4—**Tax bracket schedule . . .**

Recommendation: Retain—with modification

In view of the recommendations to impose the sales tax on periodicals and on coin-operated vending machine sales of $0.10 or under, it will be necessary to amend the first line of the formula to read:

Amount of Sale	*Amount of Tax*
$0.01 to $0.10	No tax except on sales from coin-operated vending machines at $0.10 or below, in which cases a tax of $.01 will be imposed.

[6] 12th Report, State Tax Policy Commission, 1968.

Section 5—**Transitional provisions . . .**

Recommendation: Repeal

This section deals with special circumstances surrounding the initial dates of imposition of the sales and use tax. Thus, it is no longer applicable and should be removed from the Act.

Section 8 of the Sales and Use Tax Act specifies sales which are exempt from the sales tax imposed, under Section 3, and the compensating use tax, imposed under Section 6.

8(a) **Sales of medicines and drugs**

Recommendation: Maintain—no change

The Committee, as stated above, favors continued exemption of medicines and drugs and specified related items primarily intended for the cure and/or treatment of illness or injury. This view is reinforced by the action of twenty-eight of the forty-five states which impose sales taxes but exempt medicines and drugs.

It should be re-emphasized that this exemption applies, in the case of medicine and drugs, only to those which are purchased on a physician's prescription, with other drug category purchases made at the consumer's discretion remaining subject to tax.

8(b) **Sales of food, food products, beverages . . .**

Recommendation: Maintain—with modification

From a revenue viewpoint, this existing exemption on receipts from the retail sales of food results in a revenue loss of almost $146 million. This is equivalent to more than one-fourth of the current estimated sales tax collections of $563 million. Of the forty-five states imposing sales taxes, only fifteen states and the District of Columbia tax sales of food.[7]

The Committee concludes—

That the exemption on food detailed in Section 8(b) should be continued, although with modifications as specified below. Removal of the exemption would be wholly inconsistent with the previously stated objectives of tax equity and regressivity reduction.

Achievement of these objectives mandates continued exemption from taxation of food, a basic necessity of life. It is obvious that, in most cases, the lower the personal income level, the higher the percentage of income expended for food. Therefore, imposition of the sales tax on food would unfairly and unjustifiably penalize the lower income segments of New Jersey's citizenry.

However, tax equity is not served nor is regressivity diminished through the existing exemption from the sales tax on receipts from the sale of alcoholic beverages ". . . in or by restaurants, taverns or other establishments in this State . . . (etc.)," as provided by Section 3(c) of the Sales and Use Tax Act and as discussed previously in this report. It is recommended, therefore, that the language in Section 8(b) referencing Section 3(c) be removed, along with Section 3(c) itself, *except* the provision exempting sales of food for in-flight consumption, as noted earlier.

The revenue gain from imposing the sales tax on alcoholic beverages sold for on-premises consumption is estimated at $6 million annually.

8(c) **Sales of food sold in an elementary or secondary school . . .**

Recommendation: Maintain—no change

The Committee recognizes the traditional "special purpose" treatment of food sales in school cafeterias and firmly believes that sales in this category should continue to be exempt from tax.

8(d) **Sales of articles of clothing and footwear . . .**

Recommendation: Repeal

As discussed above, limitation of the clothing exemption adds to the progressivity of the sales tax in view of the proportionately greater percentage of income expended on clothing by higher income families, as documented by the U.S. Bureau of Labor Statistics.

8(e) **Sales of magazines and periodicals . . .**

Recommendation: Repeal

The Committee concurs with the assertion contained in the Twelfth Report of the Commission on State Tax Policy that ". . . a fair distribution of the tax burden requires that any tax be applied comprehensively to the tax base, and that exemptions be granted only for compelling reasons of public policy, consistently applied." The Committee detects no ". . . compelling reasons . . ." supporting the continuance of a sales tax exemption on magazines and periodicals. Steadily increasing prices of periodicals have resulted in a market where the $.50 to $1.00 periodical no longer unusual, but the rule. The exemption on newspapers should be continued.

Revenue from a sales tax on magazines and periodicals, including mail subscriptions and newsstand sales, as well as home delivery, will reach $0.6 million annually, according to estimates furnished by the Division of Taxation.

[7] State-Local Finances and Suggested Legislation 1971—A.C.I.R.

8(f) **Casual sales except . . . motor vehicles . . . and . . . boats . . .**

Recommendation: Maintain—with modification

The basic intent of this exemption is practical and realistic from an administrative point of view. However, the Section should be modified to remove the exemptions on: (1) the casual sales of aircraft, estimated to produce $150,000 in annual revenue and (2) the sales of boats or vessels documented under Federal Bureau of Customs statutes, estimated to produce $500,000 annually.

8(g) **Sales of gas, water, steam, electricity, telephone . . . delivered to consumers . . .**

Recommendation: Maintain—no change

Several studies have shown that sales taxes on utility bills, particularly gas and electricity, are regressive.[8] Therefore, there is good reason to continue the exemption.

8(h) **Sales of motor fuels . . .**

Recommendation: Maintain—no change

The New Jersey Motor Fuels Tax Law provides for appropriate excises on the sale of such fuels. Such user-imposed excises, including those on cigarettes and alcoholic beverages, are major contributors to State revenues and have become thoroughly ingrained in the total structure of taxation and revenue policy in New Jersey. There is no compelling justification for recommending major changes in the application of excises. Minor definitional and administrative improvements are suggested, however, as covered in a separate report on the Motor Fuels Tax Law.

Excise taxes are assessed at flat rates, leading to criticism of the inherent inelasticity of such taxes. This criticism is largely unjustified and has been overcome effectvely as evidenced by the apparent willingness of all fifty states to periodically impose higher excise rates. The effect of such increases is to create demonstrable elasticity within the excise tax category.

A further alternative, worthy of consideration at some future date, is the removal of excise taxes per se and the imposition of a sales tax on all items previously subject to excise. The most obvious current disadvantage to such an alternative, however, is the differential rate structure of the sales and excise taxes. In the absence of persuasive documentation of this alternative, the Committee urges retention of the existing exemptions on excise-taxed items.

[8] *A Study of Sales and Use Taxes on the Consumption of Utility Services,* California Legislature, Assembly Committee on Revenue and Taxation, January 1970.

Accordingly, the Committee recommends retention of the existing exemption on motor fuels and in addition for similar exemptions, for equity purposes, on fuel sales to airlines for use in airplanes and to railroads for use in locomotives.

8(i) **Tangible personal property sold through coin-operated vending machines at $0.10 or less . . .**

Recommendation: Repeal

Section 4 of the Sales and Use Tax Act, as originally enacted in 1966 and as amended in 1970, exempted from tax imposition all low-end increments of spending ($0.01 to $0.16 exempt 1966-1970; $0.01 to $.10 exempt 1966-present). Section 8(i) of the Act reinforced the formula exemption in Section 4, by exempting coin-operated vending machine sales at $0.10 or less. This redundancy served the purpose of clarifying intent at the time. However, the Committee concludes, consistent with its position of broadening the tax base for equity purposes, that vending machine purchases at $0.10 or less should be subject to tax. Section 8(i) requires that the retailer maintain records of vending machine sales satisfactory to the Director of Taxation, thus it is deemed a comparatively simple task to use these same records as the basis for collecting taxes imposed as a result of repealing this exemption.

Section 4 requires modification to permit such imposition, as detailed earlier in this report.

A revenue potential of $1 million per year is estimated as a result of repealed Section 8(i).

8(j) **Sales not within the taxing power of this State under the Constitution of the United States . . .**

Recommendation: Repeal

This provision is superfluous in the Sales and Use Tax Act, since the restriction is clearly stated in the Federal Constitution.

8(k) **The transportation of persons and property . . .**

Recommendation: Maintain—no change

Two overriding considerations militate against repeal of this Section: (1) the virtually insurmountable administrative problems of imposing such a tax and (2) the fact that such transportation is conducted on an interstate, as well as intrastate, basis.

8(l) **Sales, repairs, alterations or conversions of commercial ships . . .**

Recommendation: Maintain—no change

If repeal were to be enacted, ship owners and shipyards, in all likelihood, would simply transfer business and purchases to neighboring New York and Pennsylvania, which exempt such transactions from sales tax. Thus, New Jersey not only would realize little, if indeed any, additional tax revenue as a result of repeal, but would lose valuable business activity as well, with accompanying loss of jobs, personal income and tax ratables.

8(m)(1) (Repealed by Chapter 7, Laws of 1970)

Sales of machinery, apparatus or equipment for use in the production of tangible personal property.

Recommendation: Restore Exemption

A recurring theme characterized the statements of those who appeared before the Committee's public hearings on Sales and Use Tax Act revision; namely, that failure to restore the exemption formerly provided by Section 8(m)(1) will lead to dire consequences for the economic health of the State in terms of business and industrial location, retention of industry and expenditures on plant and equipment, all of which, in turn, suggest discouraging implication for jobs, income and government revenue.

The following sampling of the testimony on 8(m)(1) delivered at the Committee's public hearings serves to underscore the grave impact of the 1970 repealer.

> ". . . spent approximately $21 million since January 1, 1950 on capital equipment along to modernize . . . and bring forward new products . . . I am sure the expenditure would never have been made had a 5% sales tax been in existence, thereby increasing this cost by over a million dollars . . ."
>
> "Most other states . . . carefully avoid such laws (sales tax on factory machinery and equipment). Some states, in fact, offer inducement in the way of tax holidays for companies willing to move from New Jersey . . ."
>
> "To survive, industrial plants located in New Jersey must compete with American industries located in many states which exempt or provide preferential treatment for investment in production facilities. Production machinery and related equipment are purchased free of State sales taxes in a majority of the nation's leading industrial states, including such states as New York, Pennsylvania, Delaware, Ohio and Indiana."
>
> "New Jersey industry's investment in new machinery is not rewarded with a credit but penalized with a tax which, necessarily, increases the sales price of manufactured goods and decreases the ability of New Jersey industries to compete successfully in the marketplace. No state wishing to encourage the growth of its industrial base and the expansion of job opportunities can afford such an obstacle to investment."
>
> ". . . a tax questionnaire (mailed) to a representative list of manufacturers located in all sections of the State (revealed that) nearly 70% of the manufacturers responding indicated that the (New Jersey sales) tax on machinery and equipment purchases would cause them to avoid or cut back on expansion or modernization in New Jersey in the future."
>
> "Short term tax gains will be more than offset by the loss of tax revenue normally generated by industrial growth."
>
> ". . . revenue generated from the sales and use tax on durable production equipment may well be more than offset by loss in industry payrolls."

This is not "scare psychology." Facts, as presented at the public hearings, and as documented elsewhere, provide irrefutable evidence outlining the consequences of the 1970 repealer of this exemption and its future implications.

Growing geographic decentralization by many corporations located in New Jersey has been noted. It has been shown repeatedly that a corporation faced with what it regards to be an extensively burdensome tax structure is one state where it maintains a facility may shift much if not all of those facilities to another corporate installation located in another state with a more tolerable system of taxation.

New Jersey must seek to foster a tax policy which will assure a healthy economy characterized by high employment and income levels stemming from the attraction, retention and expansion of business and industry throughout the state.

While a tax on production machinery carries substantial interstate competition implications, as noted, this condition is not shared by the construction industry to any significant degree. The nature of construction enterprises in terms of location restricts, if not totally eliminates, the probability that construction firms would flee the state due to imposition of the Sales and Use Tax Act.

The Committee recommends:

Corrective action to restore the exemption formerly afforded under Section 8(m)(1).

Revenue loss as a result of restoring the former exemption covered in subsection 8(m)(1) is estimated at $25 million per year.

8(n) **Sales of . . . property . . . for use . . . in research and development . . .**

Recommendation: Maintain—no change

The Committee favors retention of this exemption on the grounds that encouragement of research and development activities, as defined in Section 8(n), through non-imposition of the sales tax accrues to the long-term benefit of New Jersey's total economy. Further, the Committee believes that any tax revenues collected by repealing this exemption would be minor in comparison with the expansion of the revenue base, as a direct or indirect result of research and development enterprises.

However, so that the intent of this exemption is crystal clear, the Committee suggests that the first sentence of Section 8(n) be amended to read as follows:

"Sales of machinery, apparatus, equipment or materials for use or consumption directly and exclusively in actual conduct of research and development in the experimental or laboratory sense."

The second sentence of Section 8(n) may be maintained without change.

8(o) **Sales of wrapping paper, wrapping twine, bags, cartons . . .**

Recommendation: Maintain—no change

Wrapping paper supplies, as defined in Section 8(o), are incidental to the delivery and hence the probable sale of personal property. Thus, while the sales tax quite properly should remain on property thus delivered, an additional tax on the packaging thereof is deemed excessive and unjustifiable.

8(p) **Sales of property . . . except incorporated in a building or structure for use and consumption directly and exclusively in the production for sale of tangible personal property on farms . . .**

Recommendation: Maintain—no change

The Committee recognizes the traditional public policy toward agriculture, which while not necessarily in the form of preferential treatment, has sought to encourage, and in some cases, subsidize farm production. Consistent with this tradition, the Committee construes the exemption, contained in Section 8(p) to be an indirect subsidy to the farmer and sees no justifiable basis for revocation.

8(q) **Sales of tangible personal property sold by a mortician, undertaker, or funeral director . . .**

Recommendation: Maintain—no change

The Committee recognizes the traditional treatment accorded morticians, and undertaking in general, on the question of sales tax-exempt status. Of the forty five states imposing sales taxes, only seventeen tax morticians.

However, application of the sales tax should be continued in accordance with the provisions of the second sentence of Section 8(q) regarding property used in the conducting of funerals.

8(r) **Sales of films, records, tapes . . . to or produced for exhibition in or use through . . . theatres . . . radio and television . . .**

Recommendation—Repeal

Consistent with the conclusion that all professional services should be subject to tax where feasible, the Committee recommends repeal of the existing exemption on films, records, tapes, etc., as specified in this subsection.

It is estimated that annual revenue of $1.2 million will result from this repeal action.

8(s) **Sales of tangible personal property and services taxable under any municipal ordinance . . .**

Recommendation—Repeal

The Committee recommends repeal of Section 8(s) on two grounds: (1) the exemption as now constituted grants a discriminatory preference to a single New Jersey municipality which is inequitable and (2) it is far more desirable to collect sales taxes at the State level, rather than locally.

A sales tax revenue pick-up of $4 million annually is anticipated if this section is repealed.

8(t) **Sales . . . chemicals and catalysts, used to induce or cause a refining or chemical process . . .**

Recommendation—Maintain—with modification

A catalyst used in refining has been described as analogous to a bearing in a steel rolling mill. Neither the catalyst nor the bearing are included in the final product of either refiner or steel fabricator, yet both are vital to that end product in the purest sense of cause and effect.

In recognition of the unique role of the catalyst, therefore, the Committee recommends retention of the Section 8(t) exemption. However, to insure utmost clarity of intent, the Committee recommends addition of the phrase" . . . the exemption granted in this subsection (m) shall not apply to chemicals and catalysts, as defined herein, with a useful life of 1 year or less . . ."

8(u) **Sales of school textbooks . . .**

Recommendation: Maintain—no change

Again, reason prevails over revenue, in the case of textbooks, as in the consideration of food sold in schools [cf. Subsection 8(c).]

The students of New Jersey constitute a prime State resource. Their pursuit of educational goals will accrue to the collective benefit of all New Jersey citizens. Continuation of the textbook exemption is highly desirable in terms of encouraging academic endeavors.

8(w) **Sales made to contractors . . . of materials, supplies or services for exclusive use in erecting structures, or building on or otherwise improving, altering**

or repairing . . . real property of (exempt) organizations described in Section 9 of this Act . . .

Recommendation: Repeal—with substitution

The existing provisions of Section 8(w) are undesirable. While the original intent of the subsection was to exempt purchases by contractors engaged in government or tax-exempt organization contracts, it must be recognized that an estimated $25 million in annual revenues is lost through this exemption. A policy to restrict exemptions requires, to the contrary, that sales of all construction materials be included in the tax base, and the exempt organization would then be given a rebate for tax paid.

The Committee favors applying the tax to building material sales by wholesalers, jobbers or other vendors who sell building materials to contractors, subcontractors or other repairmen. Furthermore, the Committee recommends that a contractor's use tax be implemented to broaden the base of the tax imposed under Section 8(w).

The validity of a contractor's use tax has been upheld by the Federal courts (U.S. vs. Boyd 378 U.S. 39), despite the fact that United States government construction contracts stipulate that the title to construction materials is granted to the government.

Obviously, tax equity demands that if a contractor's use tax is imposed, it must apply to both State and local governments here in New Jersey, as well as to the Federal government. Pending the analysis of the impact of such a plan on local governments of New Jersey, government contract purchasers should continue fully rebatable.

Contractors would be required to pay this use tax directly to the State Division of Taxation and would thus be exempted from direct tax payment to wholesalers. The reporting vendor in this case would be the contractor, not the wholesaler.

The contractor's use tax offers the following advantages:

1. Purchases for use on U.S. government construction contracts could be subject to tax.
2. Fewer vendors would be involved in reporting and paying the tax, thus resulting in improved administration.

Pending the enactment of the contractor's use tax,

The Committee recommends:

Repeal of this section and extension of the tax to all construction materials, with rebates to the tax-exempt organizations.[9]

8(x) **The renting, leasing, licensing, or interchanging of trucks, tractors, trailers, or semi-trailers . . .**

Recommendation—Maintain—no change

This section of the Act was originally added to clarify the exchange of trucks and trailers engaged in intra and especially interstate commerce. The nature of the trucking business requires continuous shifting of road equipment (e.g., tractor A hauls trailer X today, but hauls trailer Y tomorrow, at which time trailer X is coupled to tractor B).

The administrative obstacles involved in imposing a sales tax on these transactions are formidable for both the industry and State. The Committee recommends continuation of this exemption.

8(y) **Sales of cigarettes subject to tax under the Cigarette Tax Act . . .**

Recommendation—Maintain—no change

Commodities subject to State excise taxes should continue to be exempt from imposition of sales taxes. Therefore, no change is recommended in Subsection (y). Proposed changes in the New Jersey excise tax structure are discussed elsewhere in this Report.

8(z) **Sales of the bible or similar sacred scripture . . .**

Recommendation—Maintain—no change

Tradition and public policy dictate the continuation of this exemption without change.

8(aa) **Sales of the flag of the United States of America and of the flag of the State of New Jersey . . .**

Recommendation—Maintain—no change

Again, as with sales of the bible, tradition and public policy prevail.

8(bb) **Sales of locomotives, railroad cars and other railroad rolling stock, including repair and replacement parts . . .**

Recommendation—Maintain—no change

The Committee has endeavored to promote balance in the revenue fabric of the State of New Jersey. Each aspect of the Sales and Use Tax Act has been tested, to determine, among other things, whether the tax, or exemption therefrom logically belongs in such an act.

The exemption on locomotives and railroad rolling stock, as contained in subsection (bb) is a case in point. Overwhelming evidence has documented the serious financial plight of New Jersey's railroads. The State has responded with direct subsidies, as well as with this sales tax exemption. The Committee supports the public policy of direct subsidies to the railroads, as well as the indirect subsidization, supplied by this exemption. Exemption 8(bb) should be continued without change.

[9] Provision should be made to assure that local governments may anticipate the rebate in the current budget.

8(cc) **Sales of buses for public passenger transportation, including repair and replacement parts therefor . . .**

Recommendation—Maintain—no change

Reasoning identical to that cited for the railroad exemption, above, applies to the existing bus exemption. Thus, continuation of exemption (cc) will supplement direct subsidization of public busing.

Section 9—**Exempt organizations . . .**

9(2) **The United States of America . . .**

Recommendation—Repeal

This section of the Act, exempting the United States of America, etc. from the sales tax should be removed due to (1) provisions of the U.S. Constitution which make Section 9(2) redundant and (2) the special provisions of Section 8(w) of the Act which specifies certain circumstances under which the tax may be applicable.

Sections 10 through 31

Recommendation—Maintain—with modification

Certain minor amendments may be required in these sections to maintain consistency with the recommendations of this report, particularly 3 and 8. However, in general, the language of each of the provisions of Sections 10 through 31 remains substantively applicable.

The Committee suggests that Sections 10 through 31 be amended by statutes when and as the foregoing recommendations for amending the Sales and Use Tax Act may be implemented.

Administration

Improved administration for the Sales and Use Tax is a desirable goal for reasons of equity, enhanced revenue collections, and greater over-all efficiency.

The cost of administering the Sales and Use Tax Act in 1970 was approximately 1 per cent of revenue collected.[10] This compares favorably with other states imposing similar taxes.

As detailed by the Tax Foundation, the costs of sales tax administration among twenty-seven reporting states range from 0.4 per cent to 3.0 per cent of collections, with fourteen states showing administration costs of at least 1.0 per cent, of collections.[11]

The Committee considered direct payments to vendors for collection of the sales and use tax. However, the idea was rejected as unjustified. There is only a superficial analogy between the vendors' activities in connection with collecting the sales tax and the activities carried on by cigarette vendors who pre-pay the excise tax on cigarettes.

Summary of Recommendations:

1. **The Committee recommends repeal of sales and use tax exemptions for the following items, with the estimated increase in State revenue for each:**

ESTIMATED REVENUE IMPACT OF PROPOSED SALES AND USE TAX ACT REVISIONS

	$ (Millions)
On-Premises Consumption of Alcoholic Beverages	6.0
Clothing and Footwear	80.0
Services	154.0
Magazines, Periodicals	0.6
Casual Sale of Aircraft and Boats	.75
Certain Coin Machine Sales	1.0
Films, Records, Tapes in Theater, Radio and Television Production	1.2
Sales Covered by Local Sales Tax	4.0
Building Materials (8w) (non-taxable)	25.0
—Clothing Rebate	— 10.0
—Machinery and Equipment	— 25.0
Total Estimated Revenue	237.55

2. **In conjunction with repeal of the clothing exemption, a system should be installed to provide credits or rebates to low-income families, to insure that there is no regressive shift of the sales tax burden. This credit/rebate system is estimated to require a total of $10 million.**

3. **The exemption of sales of machinery, apparatus and equipment used in manufacturing tangible goods should be restored before it does serious harm to the industrial base which is needed for the state's economic health, and incidentally to the base which the sales tax is levied on. This would further reduce the projected additional state revenue by $25 million."**

The net total additional revenue for the State, then, would be $237.55 million. In the 1971-72 fiscal year, this would have raised total sales tax revenues from the presently budgeted $563 million to $800.55 million.

Effect on Progressivity

The effect of the various changes on the progressivity of the sales tax has been measured, except for the extension of the tax to professional services. The latter are believed to fall in large measure on business, but there are insufficient data by income groups to calculate a progressivity index for this component.

[10] Annual Report of the Division of Taxation in the Department of the Treasury for the year 1970.

[11] Tax Foundation, "State and Local Sales Taxes," #23, 1970.

As shown in Table 5-21 the present sales tax had an unweighted progressivity index of .86 and as weighted index of .95 in 1971. The repeal of the clothing exemption itself has an index of 1.04, and in combination with the present law results in an index of .96. The table indicates similarly the effect on progressivity of other changes. The present sales tax plus all of the measured changes would have a weighted progressivity index of .99—that is, its incidence would be practically proportional to income.

The Committee Concludes:

That the recommended amendments to the sales tax would not only yield an additional $237.5 million annually, but would also produce this yield while improving the progressivity of the tax.

TABLE 5-21

STATE OF NEW JERSEY

SALES TAX INDICES OF PROGRESSIVITY WITH SELECTED CHANGES IN THE TAX BASE[1]

Tax Component	Unweighted Progressivity Index	Weighted Progressivity Index
Present $520 million sales tax	.86	.95
Repeal of clothing exemption	.94	1.04
Present sales tax plus taxing clothing sales	.87	.96
Barbers, beauticians and dry cleaning ..	.77	.90
Alcoholic beverage taxes	.73	.95
Contract construction services	.92	.96
Present sales tax plus tax on contract construction services	.87	.95
Present sales tax plus all above changes	.88	.99

[1] Without offsets for deductions from federal income tax.

Chapter XII

A State Personal Income Tax

It is the Committee's conclusion, after extensive study, that the needs and goals of tax reform, as outlined in Chapter III of this Part, require a greater utilization of personal income as a base for taxation. In arriving at this conclusion, the Committee was impressed with the widespread acceptance and utilization of the personal income tax in other states, and with the potential of such a tax for reforming the present New Jersey tax structure into a balanced and equitable system of taxation capable of relieving the present burden of excessive property taxation and of generating revenues in the future adequate to meet needs as they develop.

A State Personal Income Tax is Essential to Achieve a Balanced and Equitable Tax Structure

Over a period of almost two years of intensive study of every existing or potential revenue source, including sources utilized by other states and countries, the Committee has been forced to conclude that New Jersey's only salvation is a state personal income tax, which in turn will serve as the cornerstone of total tax reform.

A balanced and equitable tax structure requires the utilization of all of this State's major tax resources. Primary reliance on the property tax over the years has resulted in a grossly unbalanced tax structure which places an excessive burden upon property owners and users. Of the approximately $3.8 billion in revenues raised at all governmental levels in 1971, the property tax accounted for $2.2 billion, or 56.8% of such total. It is apparent that this dependency upon the property tax, as the major source of revenues in New Jersey, has had a damaging effect upon home ownership, construction of housing, and the general economic development of the State.

Left unchecked, the escalating property tax will surely destroy our suburban and rural areas, as well as our cities. It is grossly unjust to the ordinary family, homeowner and tenant; it is almost criminally unfair to the senior citizens and retired people living on fixed incomes. It is accountable, in large part, for numerous long-standing public neglects. A state ranking seventh, as New Jersey does, in per capita income, should not continue to bear the shame of this distorted, inequitable tax system.

Accordingly, in considering the imperatives for an income tax, no factor is more compelling than the necessity of giving property tax relief *now*. The burden of the property tax is more oppressive in New Jersey than in almost any other state. (See Part II of the Report) The evils of the property tax are well documented and are familiar to every taxpayer in New Jersey, including the businessman, the homeowner, and the tenant, all of whom suffer because of our undue reliance on this source of revenue. A redistribution of this burden demands the adoption of a state personal income tax.

A balanced and equitable tax system in New Jersey goes hand in hand with property tax relief. Balance and equity simply mean a distribution of taxes without excessive reliance on any single tax or category of taxes, and where a suitable blend of personal, business, property and miscellaneous tax sources is developed so that neither the wage earner, the business community, property user, nor any other individual or group in the State will contribute more than a fair share.

Some of the unique features of an income tax which make it one of the more desirable taxing methods have been summarized as follows:[1]

"A greater reliance on the personal income tax would contribute to improving the fairness of State and local taxation also by permitting a larger share of the tax burden to be adjusted to the size of the family through an exemption system—a criterion typically disregarded by the property tax and violated by the sales tax. The unique ability of the income tax to treat individuals and households with equal income grows in importance as the margin between people's incomes and their consumer expenditures widens and as family homesteads become less and less indicative of taxpaying ability."

An income tax, as New Jersey's second State level broad base tax, will provide a dependable and flexible revenue resource. Flexibility, or elasticity, is a characteristic which the income tax possesses to a greater

[1] Advisory Commission on Intergovernmental Relations, *Federal-State Coordination of Personal Income Taxes*, 1965, p. 12.

degree than does any other tax source. Thus, as the economy grows, income tax revenues will also grow. As clearly shown by authoritative tax data, an income tax contributes to economic stability, as well as being highly responsive to increases in personal income.

The amount of revenue which a given State tax structure will generate is a function of its tax base and its tax rate. If no structural changes are made, the revenue yield will vary with changes in income. If the overall income elasticity of the structure is .98, an increase in income of 10% will produce an additional 9.8% of tax revenue. Whether this will be sufficient to meet the expenditure needs of the state will depend on how expenditures vary with changes in income. Expenditure elasticity in New Jersey for the period of 1957-1971 has been found to be 1.49 (Part I, Table 8).

A review of this relationship shows that expenditures have been rising more rapidly than the elasticity rate of the State's tax structure. Absent structural changes in the system—new taxes, increased rates, etc.—this interaction will produce a budget deficit. This deficiency in the State tax structure will continue as long as the rate of increase in expenditures is greater than the overall elasticity of the tax structure. One approach toward rectifying this problem is to increase the overall elasticity of the system by placing greater reliance on high elasticity taxes.

A review of the literature shows that of the possible taxes to be used, the income tax is the one with the highest elasticity[2]—somewhere around 1.5. In other words, a 10% increase in income would produce an automatic increase in tax revenue of 15%.

Another extremely attractive aspect of a State personal income tax at progressive rates is its built-in ability to recapture, for New Jersey use, significant amounts of revenue heretofore flowing out of the State to the Federal government. This recapture characteristic results from the provision of the Federal Internal Revenue Code which permits deduction of state income taxes (in computing Federal income tax liability). This feature applies especially to higher income taxpayers. It is estimated that this provision, applied to the New Jersey income tax as proposed herein, will result in recapture of approximately 30% of the anticipated yield from the tax, dollars which would otherwise have left the State. As the New Jersey Taxpayers Association perennially points out, New Jersey pays $1.00 in taxes to the Federal government for every $.62 it receives back in the form of Federal aid. Thus, a salutary by-product of a New Jersey income tax will be its contribution toward reducing this disparity.[3]

As a result of this deduction of the state income tax from the federal income tax, it is necessary to introduce the concept of "the net burden of the state tax." Since the state tax is deducted from the federal tax by a taxpayer who itemizes his deduction, the actual cost of the state tax is the amount paid to the state minus the tax benefit derived from the federal deduction for the State income tax paid. The actual cost of the state tax is reduced by the amount of the tax paid times the taxpayer's highest marginal federal tax rate. The higher the marginal federal tax rate, the greater the extent to which the federal government shares in the payment of the state tax. This effect is demonstrated below (Table 5-32) and was taken into account in the Committee's consideration of an appropriate rate structure.

The Committee concludes that enactment of a graduated personal income tax is essential to achieve the following major imperatives:

a. provide relief from excessive property taxation.

b. establish a balanced and equitable system of taxation.

c. create a tax structure, the yield from which will grow automatically with the economic growth of the State.

d. recapture more New Jersey tax revenues now flowing to the Federal government.

Before proceeding to the pertinent details of the proposed personal income tax, these points should be stressed:

First, in establishing its posture on a personal income tax, the Commitee has not been unmindful of the po-

[2] There are two main aspects of the income tax structure which explain why its yield is highly elastic. To understand these aspects, it is necessary to understand how an income tax structure operates. Under a system in which all income is taxed at a flat rate and in which there are no personal exemptions or deductions, the income tax would have an elasticity of 1.0. However, the usual structure includes deductions and exemptions, and, accordingly, an increase in income for those who would otherwise have no taxable income (income being less than deductions plus exemptions) results in a large percentage increase in their tax. Moreover, since the tax rate is usually graduated, increased income is taxed at a higher tax rate. Thus, the two main factors which account for the high elasticity of the income tax are (1) that an increase in income will push a large segment of people into a taxable status and (2) that taxpayers with increased income will pay a higher rate of tax on their increased income.

[3] Legislation has been introduced at the Federal level (HR11950) which would prescribe a five-year program of dollar allocations to State governments with each State's share equal to 15% of the amount of that State's individual income tax collected during the previous year. This allocation would be limited for each State to 6% of the Federal individual income tax liabilities of residents and a temporary floor for two years to give each State not less than 1% of the Federal income tax liabilities. This temporary floor is intended to give those States with no personal income tax or a very nominal tax time to enact or increase such a tax. These allocations could be expended by the States as they see fit. It should be noted also that President Nixon has indicated that he expects his Commission on School Finance to make specific recommendations for relieving property tax burdens. These recommendations may result in further incentives for States to make greater use of income taxes.

tential loss of State business development that conceivably could result from such a tax. Traditionally, many firms have located in New Jersey or in Pennsylvania in preference to New York State, simply because neither of the former imposed a personal income tax. More recently, however, Pennsylvania has imposed an income tax, albeit a modification of original intent in terms of rate structure. This development, coupled with certain positive modifications to the New Jersey Sales and Use Tax Act,[4] and the continuation of the high rate New York personal income tax, should serve to neutralize, or at least minimize, any depressing influence on business development in this State which might result from a graduated income tax.

Secondly, it has been pointed out that the original Federal income tax depended for success, to a large degree, on taxpayer acceptability of the tax, as a levy which is related directly to individual ability to pay. Thus, a progressive rate structure contributes to the acceptability of an income tax, while at the same time, deductions available to upper income levels increases its palatability. *The Committee concludes that the acceptability of an income tax to New Jersey taxpayers will be directly related to the degree of total tax reform achieved in the State.*

It is the earnest aspiration and objective of the Committee that the following words, used by Joseph A. Pechman in his book *Federal Tax Policy,* to describe the Federal income tax, will apply as well to New Jersey's proposed income tax:

> "The individual income tax . . . is widely regarded as the fairest source of governmental revenues. (It) continues to be the best tax ever devised."

Design of an Income Tax for New Jersey

As a guide to the selection of the details of base, rate, exemptions and credits, it is useful to consider the experience of other states.

There are 40 states which have enacted general state individual income taxes including the Ohio tax which became effective in 1972. These states are listed in Table 5-22 by order of the enactment of the law now in effect. Both Hawaii (1901) and Alaska (1949) had income taxes when they were admitted to statehood. Table 5-23 indicates the experience or lack of it in the ten states which do not have general state income taxes. Of these states, one has enacted a general income tax which has been held unconstitutional, two have enacted and repealed income taxes, and two are prohibited from levying a general income tax. There is much variation among the states in the specific income tax provisions.

[4] A recommendation to restore the sales tax exemption on business machinery and equipment expenditures.

TABLE 5-22

INCOME TAX STATES BY DATE OF ENACTMENT

State	Year of Enactment
Hawaii	1901
Wisconsin	1911
Mississippi	1912
Oklahoma	1915
Massachusetts	1916
Virginia	1916
Delaware	1917
Missouri	1917
New York	1919
North Dakota	1919
North Carolina	1921
South Carolina	1922
Arkansas	1929
Georgia	1929
Oregon	1930
Idaho	1931
Utah	1931
Vermont	1931
Alabama	1933
Arizona	1933
Kansas	1933
Minnesota	1933
Montana	1933
New Mexico	1933
Iowa	1934
Louisiana	1934
California	1935
Kentucky	1936
Colorado	1937
Maryland	1937
Alaska	1949
West Virginia	1961
Indiana	1963
Michigan	1967
Nebraska	1967
Illinois	1969
Maine	1969
Rhode Island	1971
Pennsylvania	1971
Ohio	1971*

Source: A.C.I.R., State-Local Finance and Suggested Legislation 1971, Table 23.
* Effective for 1972.

Rate Structures: Of the 39 states with general income tax in 1971, 30 levy a graduated rate income tax, 5 levy a flat rate tax and 4 levy their tax as a percent of federal income tax liability. See Table 5-24. Income splitting in some form is allowed in 15 states— 5 have separate schedules for joint returns, 1 has a separate schedule for single returns, 5 have community property laws, and 4 incorporate the federal treatment via piggy back.

Of the 5 states with flat rates, three have rates between 2% and 2.5%, one has a rate of 3.9% (recently increased from 2.6%) and one has a dual rate

TABLE 5-23

NON-INCOME TAX STATES INCOME TAX EXPERIENCE AND CONSTITUTIONAL PROVISIONS

Connecticut—enacted tax in 1971 and repealed tax in 1971; flat rate tax on capital gains enacted in 1969—extended to dividends in 1971

Florida—Constitution prohibits an income tax

Nevada—no enactments; Constitution may prohibit graduated rates

New Hampshire—flat rate tax on dividends enacted in 1923; flat rate tax on non-resident commuters enacted in 1970; Constitution may prohibit graduated rates

New Jersey—New York commuters tax enacted in 1961; Pennsylvania commuters tax enacted in 1971; for Constitutional issues, see Chapter IX

South Dakota—enacted tax in 1935 and repealed tax in 1943; Constitution permits graduated income tax

Tennessee—tax on dividends and interest enacted in 1931; Constitutional authorization for limited tax has been interpreted as prohibiting general income tax

Texas—no enactments; Constitution may prohibit graduated rates

Washington—enacted tax in 1936, held unconstitutional

Wyoming—no enactments; Constitution may prohibit graduated rates

—5% for earned income and 9% for unearned income.

Of the 4 states which piggy back on the Federal income tax, one has a rate of 10% (reduced for 1971 from 13%), one has a rate of 16%, one has a rate of 17.5% for the second half of 1971 (will be 15% for 1972), and one has a rate of 25%—each applies to the amount of the taxpayer's federal tax due.

Base—Conformity with Federal Income Tax: Four states use Federal income tax liability with modifications as their tax base. Twenty-three states (plus Virginia in 1972) use one of the Federal definitions of income as the starting point for the computation of their tax base. See Table 5-25. Of the remaining eleven states the tax base bears a substantial resemblance to the Federal base in 5 states. Almost all of the states use Federal decisions and regulations in interpreting the provisions of their taxes.

Deductions and Capital Gains Treatment: Sixteen of the states allow the Federal income tax as a deduction. In two of these states the amount of the deduction is limited to a specified dollar amount and several of the other states include some form of limitation. Six states allow the State income tax itself as a deduction. See Table 5-26. In 32 of the 39 states, taxpayers are allowed a standard deduction. In 28 of the states the maximum standard deduction is 10%, and in 5 states it is 5%. In the 16 states which allow the Federal income tax as a deduction, the standard deduction is allowed in addition to the deduction for the Federal tax. In 10 states a minimum standard deduction of $300 is allowed. Six states allow a tax credit for certain consumer taxes paid, three states allow a tax credit for a portion of the property taxes paid by senior citizens and one state allows both types of credit. In 11 states capital gains are taxed in full and in 28 states a deduction for 50% of the capital gain is allowed if the holding period requirements are met.

Personal Exemptions: Thirty-eight states allow a personal exemption for taxpayer and spouse. Thirty-seven states allow an additional exemption for dependents, 34 for blindness and 32 for age. See Table 5-27. In 6 states the personal exemption is a tax credit rather than a deduction and this effect is achieved in 1 other state by requiring that the personal deduction be taken from the lowest income bracket. In most of the states, the exemption for married taxpayers filing joint returns is double that for single taxpayers. Of the 37 states which allow a personal exemption for dependents, the amount of the exemption is the same as for the taxpayer in 22 states and is a different and lower amount in 15 states.

Degree of Reliance on Income Taxes as a Source of State Revenue

Table 5-28 compares state individual income tax collections as a percentage of state tax collections for the period from 1940 to 1970. It shows that in 1940 state income taxes on individuals accounted for only 6.2% of total state taxes collected. By 1970 this percentage had increased three times to the point where individual income taxes constitute almost one-fifth of all state tax collections. Half of this growth has taken place in the last ten years.

In dollar terms the increased importance of state income tax collections is even more impressive. As shown in Table 5-28 income tax collections from 1940 to 1970 increased 44.5 fold (from $206 million to $9183 million) while total state tax collections increased 14.5 fold (from $3,313 million to $47,905 million). On the average during this period, income tax collections have increased by about $290 million per year compared to total state tax collections which

TABLE 5-24

UNITED STATES

PERSONAL INCOME TAX RATE STRUCTURES (1971)

	Flat	Rate	Graduated	No. of Bracket	Top Bracket	Top Rate	Piggy Back	Rate	Income Splitting
Alabama			X	5	$ 5,000	5%			
Alaska							X	16%	X
Arizona			X	7	6,000	8%			X
Arkansas			X	6	25,000	7%			
California			X	10	14,000	10%			X
Colorado			X	11	10,000	8%			
Delaware			X	15	100,000	18%			
Georgia			X	6	10,000	6%			X
Hawaii			X	11	30,000	11%			X
Idaho			X	6	5,000	9%			X
Illinois	X	2.5%							
Indiana	X	2.0%							
Iowa			X	7	9,000	7%			
Kansas			X	5	7,000	6.5%			X
Kentucky			X	5	8,000	6%			
Louisiana			X	3	50,000	6%			X
Maine			X	6	50,000	6%			X
Maryland			X	4	3,000	5%			
Massachusetts	X	5 & 9%							
Michigan	X	3.9%							
Minnesota			X	11	20,000	12%			
Mississippi			X	2	5,000	4%			
Missouri			X	10	9,000	6%			
Montana			X	10	35,000	11%			
Nebraska							X	10%	X
New Mexico			X	16	100,000	9%			X
New York			X	13	23,000	14%			
North Carolina			X	5	10,000	7%			
North Dakota			X	7	15,000	11%			
Oklahoma			X	7	15,000	6%			
Oregon			X	7	5,000	10%			X
Pennsylvania	X	2.3%							
Rhode Island							X	17.5%	X
South Carolina			X	6	10,000	7%			
Utah			X	6	5,000	6.5%			
Vermont							X	25%	X
Virginia			X	3	5,000	5%			
West Virginia			X	24	200,000	9.6%			X
Wisconsin			X	15	14,000	10%			

have increased by about $1440 million per year. State income tax collections are now the second most important source of state tax revenue with the sales tax revenue ranking first.

It should be noted that the comparisons shown in Table 5-28 use as their base total tax collections (excluding employment taxes) for *all states*. The effect of this is to dilute somewhat the importance of the individual income tax, since during most of the period covered such a tax was in force in only about 33 states. Table 5-29 gives some indication as to the extent of this dilution by comparing state individual income tax collections as a percent of state tax revenues for all states with similar figure for only those states using state income taxes. These figures indicate that the correction factor is currently about 6 percentage points.

In income tax states this source of revenue now accounts or about one-fourth of all state tax collections.

TABLE 5-25

UNITED STATES

FEDERAL BASE USED AS STARTING POINT IN STATE INCOME TAXES

		Federal Tax	Other Federal Definition	Major Resemblance	Minor Resemblance
Alabama	N				X
Alaska	Y	X			
Arizona	N			X	
Arkansas	N				X
California	N			X	
Colorado	Y		X		
Delaware	Y		X		
Georgia	Y		X		
Hawaii	Y		X		
Idaho	Y		X		
Illinois	Y		X		
Indiana	Y		X		
Iowa	Y		X		
Kansas	Y		X		
Kentucky	Y		X		
Louisiana	N			X	
Maine	Y		X		
Maryland	Y		X		
Massachusetts	Y		X		
Michigan	Y		X		
Minnesota	Y		X		
Mississippi	N				X
Missouri	N				X
Montana	Y		X		
Nebraska	Y	X			
New Mexico	Y		X		
New York	Y		X		
North Carolina	N			X	
North Dakota	Y		X		
Oklahoma	Y		X		
Oregon	Y		X		
Pennsylvania	N			X	
Rhode Island	Y	X			
South Carolina	N				X
Utah	N				X
Vermont	Y	X			
Virginia	Y(1972)		X		
West Virginia	Y		X		
Wisconsin	Y		X		

TABLE 5-26

UNITED STATES

DEDUCTIONS AND CAPITAL GAINS TREATMENT IN STATE INCOME TAXES

	Federal Tax	State Tax	Standard Deduction				Special Capital Gains Treatment	
			Allowed	10%	5%	Minimum	Yes	No
Alabama	X		X	X				X
Alaska			X	X		X	X	
Arizona	X	X	X	X			X	
Arkansas			X	X				X
California							X	
Colorado	X		X	X		X	X	
Delaware	X		X	X			X	
Georgia			X	X			X	
Hawaii		X	X	X			X	
Idaho	X		X	X		X	X	
Illinois								X
Indiana							X	
Iowa	X		X		X		X	
Kansas	X		X	X		X	X	
Kentucky	X		X		X		X	
Louisiana			X	X				X
Maine			X	X			X	
Maryland			X	X			X	
Massachusetts		X						X
Michigan							X	
Minnesota	X		X	X			X	
Mississippi			X	X				X
Missouri	X		X		X		X	
Montana	X		X	X			X	
Nebraska			X	X		X	X	
New Mexico		X	X	X		X	X	
New York			X	X			X	
North Carolina			X	X				X
North Dakota	X		X	X			X	
Oklahoma	X		X	X			X	
Oregon	X		X		X	X	X	
Pennsylvania								X
Rhode Island			X	X		X	X	
South Carolina	X		X	X			X	
Utah	X		X	X				X
Vermont		X	X	X		X	X	
Virginia			X		X			X
West Virginia			X	X			X	
Wisconsin		X	X	X			X	

TABLE 5-27

UNITED STATES

PERSONAL EXEMPTIONS IN STATE INCOME TAXES

	Single	Married Joint Return	Dependent	Blindness	Age
Alabama	$1500	$3000	$ 300	$ —	$ —
Alaska	600	1200	600	600	600
Arizona	1000	2000	600	500	1000
Arkansas*	1750	3250	6	1750	—
California	2250	4500	8	8	—
Colorado	750	1500	750	750	750
Delaware	600	1200	600	600	600
Georgia	1500	3000	700	700	700
Hawaii	650	1300	650	5000	650
Idaho	650	1300	650	650	650
Illinois	1000	2000	1000	1000	1000
Indiana	1000	2000	500	500	500
Iowa*	1500	2250	10	15	15
Kansas	600	1200	600	600	600
Kentucky*	1000	2000	20	20	20
Louisiana	2500	5000	400	1000	—
Maine	1000	2000	1000	1000	1000
Maryland	800	1600	800	800	800
Massachusetts	2000	4000	600	2000	600
Michigan	1200	2400	1200	1200	1200
Minnesota*	1050	1683	19	20	20
Mississippi	4000	6000	—	—	—
Missouri	1200	2400	400	—	—
Montana	600	1200	600	600	600
Nebraska	650	1300	650	650	650
New Mexico	650	1300	650	650	650
New York	650	1300	650	650	650
North Carolina	1000	2000	600	1000	1000
North Dakota	600	1500	600	600	600
Oklahoma	750	1500	750	750	750
Oregon	650	1300	650	650	650
Pennsylvania	—	—	—	—	—
Rhode Island	650	1300	650	650	650
South Carolina	800	1600	800	800	800
Utah	600	1200	600	600	600
Vermont	650	1300	650	650	650
Virginia	1000	2000	300	600	600
West Virginia	600	1200	600	600	600
Wisconsin	370	740	10	—	5

* Exemption stated as a tax credit; credit has been converted to deduction equivalent for taxpayer and spouse.

This represents an increase of about 2.5 times since 1940, including added states and structural changes.

The increasing reliance on the income tax as a source of state revenue is the result of many components. These components can be classified as of two general types—structural factors and growth factors. The structural factors include new enactments, rate changes, and redefinitions of base and exemptions. Growth factors include real as well as inflationary growth coupled with the high elasticity of the income tax. An analysis of these factors by the ACIR[5] for fiscal years 1966 to 1969 produced the following results:

	Percent of growth attributable to: Growth Factors	Structural Factors
All States	67.8	32.2
New England & Mideast	75.3	24.7
Midwest & North	49.6	50.4
South & Southwest	89.2	10.8
West & Northwest	61.0	39.0

[5] ACIR, State-Local Finance and Suggested Legislation 1971, Table 8.

TABLE 5-28

UNITED STATES

TOTAL STATE TAX COLLECTIONS
AND
STATE INDIVIDUAL INCOME TAX COLLECTIONS
1940-1970
($ Millions)

Year	(1) Total State Tax Collections	(2) State Individual Income Tax Collections	(3) (2) ÷ (1)
1940	$ 3,132	$ 206	6.2%
1945	4,349	357	8.2%
1950	7,930	724	9.1%
1955	11,597	1,094	9.4%
1960	18,036	2,209	12.2%
1965	26,126	3,657	14.0%
1966	29,380	4,288	14.6%
1967	31,926	4,909	15.4%
1968	36,400	6,231	17.1%
1969	41,931	7,527	18.0%
1970	47,905	9,183	19.2%

Source: Tax Foundation, Facts and Figures on Government Finance 1971, Tables 134 and 135.

TABLE 5-29

UNITED STATES

COMPARISON OF INDIVIDUAL INCOME TAX COLLECTIONS AS A PERCENTAGE OF TOTAL STATE TAX COLLECTIONS

ALL STATE AND INCOME TAX STATES
SELECTED YEARS, 1950 TO 1970

Year	Percentage All States	Percentage Income Tax States
1940	6.2	10.5
1945	8.2	13.7
1950	9.1	14.1
1955	9.4	15.1
1960	12.2	20.0
1965	14.0	21.9
1968	17.1	24.6
1969	18.0	24.0
1970	19.2	25.6

Source: Melichar, E., State Individual Income Taxes, University of Connecticut 1961, Table 2, page 31; and derived from figures of the Department of Commerce, Bureau of Census.

Based upon the experience of other States, it may be concluded that the pattern of growth is diverse and is dependent upon local economic conditions and political decisions.

Turning now to the experience in individual states, Table 5-30 shows the total tax collections in 1970 in each state and the amount attributable to individual income taxes both in dollar and percentage terms. The range in dollar terms in from $15.4 million in North Dakota to $2,506.4 million in New York. The median is $95.4 million in North Carolina and the average is $246.6 million. In 19 states income tax collection amounted to less than $100 million, in 10 states they were between $100 and $300 million, in 4 states they were between $300 and $500 million, and in 4 states they were over $500 million. The range in percentage terms is from 5.7% in Louisiana to 49.5% in Oregon.

The median percentage of income tax to total state collections is 20.1% in California and Illinois and the average is 22.75%. In 10 states income tax collections amounted to less than 15%, in 14 states they were between 15 and 25%, and in 7 states between 25 and 35%, and in 6 states they were over 35%.

Perhaps a more meaningful comparison of State income tax collections is its relation to personal income in the individual states. Table 5-31 presents figures on 1970 individual income tax collections and 1969 total personal income by states. Income tax collections are then expressed as a percentage of personal income. Since the personal income figures contain a built-in population factor the result is adjusted for both State wealth and population and is an indication of the average effective tax rate. Both the income tax collection figure and the percentage result have been ranked from highest to lowest.

Table 5-31 shows that income tax collections as a percentage of total personal income in the State range from a high of 3.45% in Wisconsin to a low of .26% in Alaska. The median state is Georgia at 1.30% and the average rate is 1.75%.

The Proposed Income Tax

Forty states now levy some form of broad based individual income tax. As has been shown, the taxes vary substantially in their rates, exemptions and deductions, and in their degree of progressivity. In recommending the components of an income tax for New Jersey, the Committee has studied the policy and technical consideration which are involved in the design of a State income tax, including particularly the interrelated effects of exemptions, deductions and credits and the varying rate structures.

Our principal guidelines in the design of an income tax for New Jersey has been twofold: first to raise the revenue required to give effect to the Committee's recommendations for massive relief of real estate, and,

TABLE 5-30

INDIVIDUAL INCOME TAX COLLECTIONS IN DOLLARS AND AS A PERCENTAGE OF TOTAL STATE TAX COLLECTIONS, BY STATES, FISCAL YEAR 1970

State	Total Tax Collections ($millions)	Individual Income Tax ($millions)	Individual Income Tax as % of Total Collection (%)
Alabama	657.4	85.1	12.9
Alaska	85.9	32.5	37.8
Arizona	474.3	65.0	13.7
Arkansas	351.5	42.5	12.1
California	5,497.5	1,150.6	20.1
Colorado	470.1	129.1	27.5
Connecticut	—	—	—
Delaware	195.6	68.5	35.0
Florida	—	—	—
Georgia	941.3	184.9	19.6
Hawaii	340.5	105.0	30.1
Idaho	155.9	36.7	23.5
Illinois	2,868.7	575.6	20.1
Indiana	1,002.4	216.4	21.6
Iowa	678.3	112.7	17.9
Kansas	431.0	78.4	18.2
Kentucky	703.0	121.4	17.3
Louisiana	838.8	48.0	5.7
Maine	207.6	18.9	9.1
Maryland	1,082.1	413.4	38.2
Massachusetts	1,393.7	518.0	37.2
Michigan	2,345.1	415.3	17.7
Minnesota	1,021.0	345.7	33.9
Mississippi	485.8	44.2	9.1
Missouri	820.9	129.7	15.8
Montana	128.8	38.9	30.2
Nebraska	261.3	44.4	17.0
Nevada	—	—	—
New Hampshire	—	—	—
New Jersey	—	—	—
New Mexico	266.5	35.7	13.4
New York	6,116.5	2,506.4	41.0
North Carolina	1,190.2	270.9	22.8
North Dakota	121.6	15.4	12.7
Ohio	—	—	—
Oklahoma	502.1	50.5	10.1
Oregon	430.7	213.1	49.5
Pennsylvania	—	—	—
Rhode Island	—	—	—
South Carolina	543.7	95.4	17.5
South Dakota	—	—	—
Tennessee	—	—	—
Texas	—	—	—
Utah	251.6	61.3	24.4
Vermont	135.2	43.7	32.3
Virginia	955.7	282.8	29.6
Washington	—	—	—
West Virginia	385.0	40.1	10.4
Wisconsin	1,332.8	489.9	36.8
Wyoming	—	—	—

Source: Tax Foundation, Facts & Figures on Government Finance 1971, Table 136, and derivations therefrom.

TABLE 5-31

COMPARISON OF INDIVIDUAL INCOME TAX COLLECTIONS TO PERSONAL INCOME BY STATES

State	Individual Income Tax Collections (1970)		Total Personal Income (1969)	Individual Income Tax Collection as a % of Personal Income	
	($millions)	(Rank)	($millions)	(%)	(Rank)
Alabama	85.1	(20)	9,116	.93	(27)
Alaska	32.5	(35)	1,258	.26	(37)
Arizona	65.0	(23)	5,709	1.14	(24)
Arkansas	42.5	(30)	4,963	.86	(29)
California	1,150.6	(2)	83,408	1.38	(16)
Colorado	129.1	(15)	7,569	1.71	(15)
Connecticut	—				
Delaware	68.5	(22)	2,218	3.09	(3)
Florida	—				
Georgia	184.9	(13)	14,253	1.30	(19)
Hawaii	105.0	(18)	3,060	3.43	(2)
Idaho	36.7	(33)	2,120	1.73	(14)
Illinois	575.6	(3)	47,340	1.22	(21)
Indiana	216.4	(11)	18,868	1.15	(23)
Iowa	112.7	(17)	9,870	1.14	(24)
Kansas	78.4	(21)	8,096	.97	(26)
Kentucky	121.4	(16)	9,202	1.32	(18)
Louisiana	48.0	(26)	10,413	.46	(36)
Maine	18.9	(36)	2,987	.63	(35)
Maryland	413.4	(7)	15,336	2.70	(7)
Massachusetts	518.0	(4)	22,722	2.28	(9)
Michigan	415.3	(6)	35,010	1.18	(22)
Minnesota	345.7	(8)	13,448	2.57	(8)
Mississippi	44.2	(28)	5,234	.84	(31)
Missouri	129.7	(18)	16,085	.81	(33)
Montana	38.9	(32)	2,172	1.79	(13)
Nebraska	44.4	(27)	5,230	.85	(30)
Nevada	—				
New Hampshire	—				
New Jersey	—				
New Mexico	35.7	(34)	2,879	1.24	(20)
New York	2,506.4	(1)	81,384	3.08	(4)
North Carolina	270.9	(10)	15,030	1.80	(12)
North Dakota	15.4	(37)	11,852	.83	(33)
Ohio	—				
Oklahoma	50.5	(25)	7,825	.65	(34)
Oregon	213.1	(12)	7,261	2.93	(6)
Pennsylvania	—				
Rhode Island	—				
South Carolina	95.4	(19)	7,018	1.36	(17)
South Dakota	—				
Tennessee	—				
Texas	—				
Utah	61.3	(24)	3,132	1.96	(11)
Vermont	43.7	(29)	1,426	3.06	(5)
Virginia	282.8	(9)	14,154	2.00	(10)
Washington	—				
West Virginia	40.1	(31)	4,426	.91	(28)
Wisconsin	489.9	(5)	14,207	3.45	(1)
Wyoming	—				

Source: Derived from Tax Foundation, Facts and Figures on Government Finance 1971, Tables 28 and 138.

secondly, to do so with a tax structure that would be comparable to the average or median practice among the states that have income taxes.

The Committee interpreted this to require a progressive tax structure with moderate rates graduated according to income, and that the tax should take into account family size, expenditure patterns and parallel the federal income tax system to the extent necessary to avoid undue confusion. These guidelines were employed in the context of providing, first, a revenue yield large enough to provide, together with other tax adjustments, meaningful immediate property tax relief. Secondly, the revenue structure must have the capacity to produce future revenues sufficient to sustain this relief as well as meet future state needs.

The Committee recommends:

That a New Jersey graduated personal income tax include, among other, the following characteristics:

a. flexibility and yield sufficient to constitute a foundation for true tax reform, including massive property tax relief in New Jersey;

b. close conformity to Federal income tax rules for the convenience of the New Jersey taxpayer;

c. a rate structure and credit system that will be progressive and equitable;

d. a rate structure and credit system designed to insure that the tax will not impinge in any way on the basic necessities of life for many hundreds of thousands of New Jersey families; and

e. a graduated tax approximating, for most New Jersey taxpayers, one-half of the rates paid by New York taxpayers.

The Committee estimates than such a tax will yield first full year revenues of $550 million.

Tax Rate Schedule: The income tax rate schedule recommended by the Committee is as follows:

Taxable Income*	Tax on Column 1	Percent on Excess
$ —	$ —	—
1,000	10	1.5
3,000	40	2
5,000	80	2.5
7,000	130	3
9,000	190	3.5
11,000	260	4
13,000	340	4.5
15,000	430	5
17,000	530	5.5
19,000	640	6
21,000	760	6.5
23,000	890	7
25,000	1,030	7.5
30,000	1,405	8
40,000	2,205	8.5
50,000	3,055	9
75,000	5,305	9.5
100,000	7,680	10

Taxable Income	Tax on Column 1	Percent on Excess
$ —	$ —	—
150,000	12,680	10.5
200,000	17,930	11
300,000	28,930	12
400,000	40,930	13
500,000	53,930	14

These rates are equal to one-half of existing New York State income tax rates up to a taxable income level of $23,000. The proposed tax rates would be activated at the $1,000 taxable income level. The rates do not exceed the 5% level until taxable income exceeds $15,000. The graduated rates continue until the $500,000 level thus assuring continued progressivity of the tax structure. The Committee is of the view that the rate schedule in conjunction with the deductions and personal exemptions recommended will produce a fairly apportioned, low effective rate, progressive income tax structure.

It is projected that the proposed income tax structure as designed will produce first year tax revenues of $550 million dollars. This will constitute about 20% of total state revenue, which will place New Jersey in line with the median percentage among the states in degree of reliance on a state income tax for state revenue, and slightly below the average state percentage reliance. See Table 5-30.

In relation to total personal income in the state, the projected tax yield will constitute about 1.5%. This figure is between the median state percentage and the average state percentage of yield from the state income tax (measured in terms of total personal income). See Table 5-31.

The Tax Base. In defining the tax base the Committee concluded that, both for sound policy reasons and for administrative simplicity, one of the federal definitions of income, should be used as the definition of taxable income.

Under the Federal Internal Revenue Code there are three major components of the tax base: (1) gross income, (2) adjusted gross income, and (3) taxable income. Each of them serves a particular purpose in the context of the overall Federal income tax structure.

Gross income is the definition by which the gross tax base is defined. By incorporating other provisions of the Code it in effect provides what income items are nontaxable. Gross income is defined as income from all sources except those items specifically excluded by the Internal Revenue Code. These items of excluded income thus never enter into the gross tax base (to be distinguished from deductible items). A list of some of the more important of these excluded items is as follows (stated in general terms):

- Accident and health insurance proceeds
- Bequests and devises
- Child support payments
- Damages for certain torts
- Dividends to extent of $100.
- Employees' death benefits up to $5000.
- Gain by taxpayers over 65 on sale of personal residence
- Gifts
- Group life insurance coverage provided by employers
- Interest on State and local government bonds
- Life insurance proceeds
- Medical care payments under employer financed plans
- Parsonage rental value
- Railroad retirement act benefits
- Scholarship and fellowship grants
- Sickness and injury benefits
- Social Security and disability benefits
- Unemployment compensation benefits
- Veterans benefits
- Workmen's compensation acts payments

Adjusted Gross Income is an intermediate concept which is not operative by itself but is used primarily as a base for computing the limitations on certain deductions e.g. medical expenses, charitable contributions, standard deduction. Adjusted gross income is defined as gross income minus certain deductions authorized by the Internal Revenue Code in arriving at adjusted gross income. These authorized deductions are generally in the nature of business expenses. Some of the major categories include:

- Business bad debts
- Contributions to self-employed retirement plans
- Depreciation
- Education expenses
- Employee business expenses:
  - Meals and lodging away from home
  - Certain travel expenses
  - Reimbursed expenses
- Long term capital gain—50% of net
- Moving expenses
- Trade or business expenses of employer
- Trade or business losses

Taxable Income is the base on which the tax rate is applied to compute tax liability. It is computed by subtracting authorized deductions and personal exemption allowances from adjusted gross income.

Thus, having decided that the tax base should be fashioned after the Federal tax laws, the question was the extent to which the State income tax should conform to the Federal structure. The four possible tax bases, ranked from most conformity to least, are:

(a) Federal Tax Liability (The Piggy Back Alternative)—the State income tax would be a percentage of the Federal tax liability. This would incorporate all of the Federal exclusions, deductions, exemptions, and classifications as well as the Federal rate schedule into the State tax structure. The State would set the rate to be applied to the Federal tax.

(b) Federal Taxable Income—this would be the same as (a) except that the State would also prescribe the treatment as among joint returns, single returns and other classifications.

(c) Federal Adjusted Gross Income—this would be the same as (b), but would also leave it to the State to prescribe personal deductions and exemptions.

(d) Federal Gross Income—this would be the same as (c), but would leave it to the State to prescribe certain additional deductions mainly related to business expenses.

In evaluating these alternatives the Committee determined that a tax base of "federal adjusted gross income" would provide a fair and workable definition. This would leave to the State considerable flexibility in departing from the personal deductions prescribed by the Internal Revenue Code and, more importantly, would allow the use of a credit system for personal exemptions rather than a deduction system. At the same time, it would provide sufficient conformity to result in a substantial simplification of the structure.[6]

It should also be noted that even the tax base of "federal adjusted gross income" should be modified, for example to exclude interest on federal obligations and to include interest on state and local obligations, except of New Jersey and its political subdivisions.

Income Splitting. The Committee recommends only one tax rate schedule. No separate schedule is recommended for married taxpayers filing jointly or for unmarried heads of households. While joint returns should be permitted, the concept of income splitting should be avoided. Two distinct reasons support this position: 1) tax equity, through the avoidance of discriminatory provisions resulting from marital status, and 2) administrative simplification through the avoidance of separate schedules and the concomitant additional administrative burden generated thereby.

The Committee also proposes that where separate returns are filed by spouses that deductions clearly

[6] The reasons for rejecting the piggy-back alternative are explained in a separate section, *infra*.

allocable to one or the other should be included in that individual's tax return. In those cases where allocation cannot be ascertained, it may be assigned, for deduction purposes, to either spouse.

Personal Exemption as a Credit. All states which have State income taxes (except Pennsylvania) allow personal exemptions in one form or another. The classes of exemptions are adults, dependents, and additional relief on account of blindness and age. The types of exemptions which are allowed and the amount of the exemption vary greatly among the states. (See Table 5-27)

Perhaps the most important question concerning the exemption is how it should be implemented, through a deduction or a tax credit. By allowing the exemption in the form of a deduction, the tax benefit of the deduction varies as income increases, being the amount of the deduction times the marginal tax rate. Accordingly, as income increases the graduated rate results in the tax benefit of the deduction being increased. A method of controlling the effect of having a deduction coming off the highest rate bracket rather than the lowest is to state the deduction as a credit. Thus, the tax benefit from the personal exemption would be the same for all families of the same size. What this means is that the credit can be fixed in conjunction with the tax rate so as to exempt a fixed amount of income for persons in various family situations.

The Committee, after much deliberation, has determined that the most progressive means of allowing personal exemptions to individual taxpayers and members of their household is through a flat rate per capita credit to be deducted from the amount of tax liability. This is a distinct departure from the Federal approach of allowing a flat rate dollar deduction which is deducted in arriving at taxable income. The New Jersey flat rate per capita credit should be unrestricted in terms of family size and, of greater importance, should result in total relief from imposition of the income tax for the lowest income groups. The aged and the blind would be allowed a double credit.

The Committee has determined that a flat rate personal credit against tax liability of $15 per capita provides a distinct tax advantage to the low income taxpayer group and thus promotes the progressivity of the graduated tax. It should be noted that the income tax is particularly suited to provide this type of selected relief from taxation to the lower income classes. The credit approach together with the low income standard deduction (discussed in the next section) would mean that families of the following sizes would have no State income tax liability if their adjusted gross income were below the amounts shown:

Family Size (or number of credits)	Income Level Below Which There is no State Income Tax Liability
1	$2633
2	$3633
3	$4550
4	$5300
5	$6050
6	$6700
7	$7300

Deductions—Standard and Low Income. The Committee recommends that the standard deduction feature of the Federal income tax be adopted by New Jersey and further that it be pegged at authorized 1972 Federal rates of 15% of A.G.I. or $2,000, whichever is lower, and that the special low-income standard deduction, built into the Federal tax tables and projected at $1,300 for 1972, also be adopted.

Deductions—Itemized. The Committee further recommends that allowable deductions, for purposes of determining taxable income within the context of the proposed New Jersey personal income tax, should follow Federal regulations as currently promulgated and authorized through 1972. These deductions are basically sound, historically proven and generally acceptable to taxpayers. However, the Committee does recommend departure from the Federal Internal Revenue Code where compelling justification exists to do so.

In particular, the entire complex question of depletion, and related issues, pertaining to the income tax, is of sufficient impact to merit special and intensive study in the near future, to insure fair and equitable treatment within the New Jersey Income Tax framework.

Sales Tax Credit. One of the broad policy goals of the Committee has been to improve the progressivity of the total state and local tax system. The sales tax credit recommended in Chapter XI of this Part will be of major advantage in that respect, and will also justify less concern with questions of regressivity in the sales tax. Accordingly, the Committee's recommendations with respect to the sales tax are more appropriately covered in the context of the sales tax discussion.

Renters' deduction. Under the federal income tax laws, homeowners are allowed to deduct their local property tax in determining their taxable income. Although, it is generally acknowledged that a portion of the rent paid by tenants constitutes real estate taxes passed on by the owner of the property, the federal tax law has not given recognition to this fact. In order to partially rectify this "discrimination" against renters, the Committee recommends that tenants be allowed a deduction in the amount of 20% of their net rents paid. It is understood that this may, in effect, provide a double deduction for property taxes paid (i.e., the owner's deduction and the tenant's deduction); however, it is the Committee's position that this deduction is necessary to provide equality of treatment for both tenants and owners.

In addition, it is the Committee's strong view that tenants should be in the position of negotiating rent reductions based on the degree of property tax relief provided to owners. To the extent that market imperfections do not allow this relief, the renters deduction will at least assure that a portion of the property tax relief is passed on to renters.

Preference Income Items. The Committee recommends that preference income items,[7] as specified by Federal regulations, be taxed in the New Jersey Statute at 3%, which is one-half of the recently increased New York State rates, and thus consistent with the proposed basic income tax rate schedule.

Summary of the Proposed Tax Structure

1. Taxable Income

"Adjusted gross income" for federal tax purposes, with some modifications less deductions.[8]

2. Deductions

a. Either itemized deductions, as in the present Federal income tax, plus a renters' deduction, *or*

b. Percentage standard deduction of $2,000 or 15% of adjusted gross income, whichever is less;

c. With a special low income allowance of $1,300 to coincide with the Federal minimum standard deduction for 1972.

3. Rate Structure

Approximately one-half New York State rates through the New York State (1971) rate brackets, and continuing with additional brackets to a maximum of 14% at $500,000 or more of taxable earnings (see Rate Table attached).

There would be a single rate schedule. Joint returns would be permitted, but income splitting (which gives married taxpayers an advantage over unmarried taxpayers) would not be permitted.

4. Personal Tax Credit in lieu of Exemptions

The federal system of allowing personal exemptions tends to be of greater advantage to the high bracket taxpayer than to the low bracket taxpayer, and also results in a greater loss of revenue to the State. For this reason, the Committee recommends a credit of $15 for the taxpayer and each dependent, to be deducted from the tax liability first computed without the credit.

The aged and blind would be allowed a double credit, comparable to the Federal provision for double exemptions.

5. Withholding

A withholding and current tax payment system would also be provided.

A Piggy-Back Alternative?

The nature and structure of the income tax proposed by the Committee is so closely analogous to the Federal system that the possibility of a direct piggy-back on the Federal tax return naturally suggests itself. Alaska, Nebraska, Rhode Island and Vermont have adopted such a system, under which the taxpayer pays a percentage of his Federal tax liability to the State as State income tax. The Alaska tax is 16% of the Federal tax liability, Rhode Island 17.5%, Vermont 25% plus a 15% surcharge, and the Nebraska rate is fixed annually depending upon State requirements (for 1971 it was 10% and for 1972 it is 15% of the Federal liability).

The piggy-back approach is not as simple as it first appears, nor are the claimed advantages unavailable through more conventional means. These may be evaluated as follows:

A simple form of State return: The return is not so simple for the reason that there are always a number of adjustments to be made which do not permit a simple percentage of the Federal tax liability to be calculated directly. For example, State returns must provide for allocation of income earned by non-residents, the State may wish to tax the interest received by its residents on State and municipal bonds of other States, whereas the Federal government may not constitutionally reach such interest, the State may not as a matter of policy wish to provide any advantage to married taxpayers as compared with unmarried taxpayers, whereas the Federal government adopted this approach by the need to equalize the treatment of community property and non-community property states, and the state cannot tax the interest on Federal obligations. Whatever simplicity is attainable therefore, may well be implemented administratively by permitting taxpayers to file a copy of the Federal tax return wth the State administration, to be used for such schedules as are pertinent.

Reduced administrative cost: It would appear that a single Federal examination of a tax return could

[7] "Tax Preference" items were introduced by the Federal Revenue Act of 1971, and include the following: excess investment interest, capital gains, accelerated depreciation on real property and on personal property subject to a net lease, percentage depletion, amortization, stock options, etc. IRC, Section 57, as amended.

[8] Cost basis for capital gains shall be as of date of enactment of the state income tax.

cover the State requirements, if a piggy-back plan were used. In fact, this advantage could be achieved by a cooperative audit program which State and Federal administrators now use to varying extents in other taxes. Moreover, pure Federal examination and audit is apt to have costs of its own which could offset whatever savings might accrue from a single examination of a return. These extra costs include the expense of separating returns and the tax liability by State in a very complex Federal system now organized regionally, the probable reduced revenues to the State where the examination is subordinate to national administrative requirements and national enforcement policies; and the need to have at least a minimal State organization to respond to taxpayer requirements and to assure the State that its laws are being effectively enforced. The Mills Bill, (H.R. 11950) would provide for optional Federal collection of State income taxes. If this proves to be workable, despite the Committee's reservations, the structure of the tax proposed by the Committee for New Jersey would be adaptable to the use of the Federal administration and enforcement machinery.

There are a number of positive disadvantages to the piggy-back system for New Jersey which, in the Committee's judgment, would make it unacceptable. These are as follows:

1. The system would tend to tie New Jersey State tax policy to Federal tax policy. Under the Committee's proposal, the State could take advantage of whatever efficiencies might be developed for cooperative administration with the Federal government, but the State remains free to develop and effectuate its own policy decisions. Under the piggy-back scheme, the State is in effect married to the Federal structure and detail, and any divorce would be extremely confusing if not impractical.

2. There is serious legal doubt whether a piggy-back scheme would be permissible under the terms of the New Jersey Constitution. Such a scheme tends to delegate the policy-making power of the State to the U.S. Congress, and also appears to incorporate by reference the entire personal income tax structure of the Internal Revenue Code. While it might be argued that these features of the piggy-back could possibly be constitutional under decisions of the New Jersey Supreme Court, the doubt is sufficiently substantial that no responsible policy-maker would be justified in risking the whole tax reform program on the outcome of litigation. While the tax structure proposed by the Committee paralleling the Federal income tax offers obvious advantages, it does not change automatically with any change in the Federal law, and the legislature is free to review annually whatever changes the Congress may have had and to determine independently whether such changes would represent sound public policy for New Jersey.

Taxing Non-Residents and Resident Commuters

Non-Residents' Income. New Jersey's limited land area coupled with its strategic location in the northeast megalopolitan region has contributed, among other factors, to the fairly common employment situation where a non-resident of New Jersey may earn at least a portion of his income in this State. For purposes of the Committee's recommendations, a non-resident is defined in accordance with the definition appearing in the New York State income tax statute, viz.:

> A person who maintains a permanent place of abode outside the State and ". . . a person, though domiciled in the State, maintains no permanent place of abode within the State, but does maintain a permanent place of abode without the State and who spends in the aggregate not to exceed thirty days of the taxable year within the State."

The Committee considered a proposal to tax non-residents on the basis of their entire income with the tax reduced by the percentage which their out of state income bears to their total adjusted gross income. This approach was rejected because it was felt that this proposal would trigger retaliation by other states, with the net result that New Jersey commuters out of the State would be subjected to higher taxes to be paid to other states.

The Committee recommends that:

Non-residents be taxed only on their income earned in New Jersey. This would be a continuation of the policy expressed in the present "Emergency Transportation Act," which should be repealed. This approach facilitates a current withholding of the income tax at the source.

Resident Commuter Income. There are a substantial number of New Jersey residents who earn their income out of the State. Under existing arrangements, these commuters pay tax on their out-of-state income to the State in which their income is earned. So as to lessen the impact of the New Jersey income tax on these commuters who would otherwise be subject to full double taxation, the Committee believes it essential that a form of tax credit should be allowed for the income taxes paid to other states.

The Committee considered a proposal to allow a full credit for out of state income taxes paid. However, the effect of this would be to allow New Jersey commuters to a state with higher tax rates (e.g., New York) to have a portion of their out of state credit applied to income not earned out of state. A fairer approach would be to limit the credit in those cases to the ratio of out-of-state income to total adjusted gross income.

The Committee recommends that:

Resident commuters shall compute the tax on their entire income and be allowed a credit against the New Jersey income tax liability in the amount of income tax paid to other states, provided that the tax credit may not exceed the New Jersey tax multiplied by the ratio which the out-of-state income bears to the taxpayer's total adjusted gross income.

Effective Tax Rates

The net effect of the proposed income tax on a taxpayer may be estimated from Table 5-32. The table illustrates the operation of the proposed tax both before and after the federal income tax computation for a family of five at selected adjusted gross income levels.

It is notable that the effective rates of the tax computed by using the net burden of the tax after federal offset, for the sample family shown, ranges from zero percent at $5,000 of adjusted gross income to 2.45% at $50,000. The effective tax rates show a marked pattern of increase with rising income.

Progressity of the Proposed Tax. As explained in Chapter III of this Part a progressive tax is one in which the effective tax rate increases as income increases. A tax with a progressivity index in excess of 1.0 is classified as progressive. The progressivity indexes for the major New Jersey taxes are shown in Tables 5-11, 5-12, and 5-13. Using the same method of computation, the progressivity index of the proposed income tax is estimated to be as follows:

	With Offsets	Without Offsets
Unweighted:	2.34	2.38
Weighted:	2.36	2.40

This shows a high degree of progressivity which exceeds that of the federal income tax (1.57). This will increase the overall level of progressivity for the entire state tax structure. The enactment of the proposed income tax will thus achieve one of the goals of major tax reform.

TABLE 5-32

COMPUTATION OF FEDERAL AND PROPOSED STATE INCOME TAX LIABILITY AT SELECTED LEVELS OF ADJUSTED GROSS INCOME FOR A FAMILY OF FIVE

(1)	(2)		(3)		(4)	(5)		(6)	(7)	(8)
	(a) Itemized Deduction	(b)	(a) Personal Exemption	(b)		(a) Federal Tax Liability	(b)			
Adjusted Gross Income	for federal return (2b) + (4)	for N. J. return	federal deduction	N. J. credit	N. J. Tax Liability	with deduction of N. J. income tax	without deduction of N. J. income tax	Tax Benefit of deduction of N. J. tax from federal income tax (5b) — (5a)	Net Burden of N. J. Income Tax (4) — (6)	Effective Tax Rate of N. J. Income Tax (7) ÷ (1)
$ 5,000	$ 1,300	$ 1,300	$3,750	$75	$ 0	$ 0	$ 0	$ 0	$ 0	0%
7,500	1,530	1,500	3,750	75	30	325	330	5	25	0.33
10,000	2,085	2,000	3,750	75	85	651	668	17	68	0.68
12,500	2,650	2,500	3,750	75	150	1,019	1,048	29	121	0.97
15,000	3,225	3,000	3,750	75	225	1,385	1,435	50	175	1.17
17,500	3,810	3,500	3,750	75	310	1,587	1,655	68	242	1.38
20,000	4,405	4,000	3,750	75	405	2,226	2,321	95	310	1.55
22,500	5,010	4,500	3,750	75	510	2,695	2,823	128	382	1.70
25,000	5,625	5,000	3,750	75	625	3,166	3,330	164	461	1.84
27,500	6,250	5,500	3,750	75	750	3,680	3,890	210	540	1.96
30,000	6,885	6,000	3,750	75	885	4,202	4,460	258	627	2.09
50,000	12,130	10,000	3,750	75	2,130	9,550	10,453	903	1,227	2.45

SECTION D — MISCELLANEOUS EXCISES

Chapter XIII

The Alcoholic Beverage Tax

Description

The alcoholic beverage tax in New Jersey is controlled by Chapter 1, Title 33, Revised Statutes, The Alcoholic Beverage License Law, and Chapters 41 to 47, Title 54, Revised Statutes, The Alcoholic Beverage Tax Law. These statutes provide a per gallon tax to be imposed on the delivery or sale of alcoholic beverages intended for eventual consumption. The tax is administered by the Beverage Tax Bureau of the Division of Taxation. The current applicable rates are as follows:

a. Beer—$0.03⅓ per gallon or fraction thereof;
b. Liquor—$2.30 per gallon;
c. Still Wines—$.10 per gallon
d. Vermouth—$0.15 per gallon;
e. Sparkling Wines—$0.40 per gallon.

Revenue and consumption trends are shown in Table —

The Committee recommends:

The existing tax rate of $2.30 per gallon on liquor should be unchanged.

Three factors led to this conclusion. First, ABC statistics show that in New Jersey a slower rate of growth in tax revenues has been apparent since New York liquor prices generally were reduced following removal of Fair Trade Laws in 1967. An increase in New Jersey liquor taxes could deprive New Jersey dealers of a substantial portion of the existing market thereby reducing the amount sold, taxes collected, and creating undue administrative problems. Second, the liquor tax was increased by $.50 per gallon in 1969 to $2.30 per gallon. Third, these rates are of a magnitude comparable to neighboring states, as is shown in following column.

State	Rate
Connecticut	$2.50 per gallon
Delaware	$.90 to $2.00 per gallon
Maryland	$1.50 per gallon and up
New York	$2.25 per gallon
NEW JERSEY	$2.30 per gallon

Wine Taxes

For wines, the competitive position of wine taxes will tolerate a modest change.

The Committee recommends:

Rate increases to $0.20 per gallon on still wines, $0.30 on vermouth, and $0.50 on sparkling wines. The estimate of revenue yield is $1,000,000.

Current rates in surrounding states:

State	Rate
Connecticut	$.25 to $.625 per gallon
Delaware	$.80 per gallon
Maryland	$.20 per gallon
New York	$.10 to $.53⅓ per gallon

Beer Taxes

The committee notes that the 3⅓¢ per gallon tax on beer in effect without change since its imposition in 1933 is the lowest in the country, now a full 11⅔¢ below the national average. Rates in neighboring states suggest that an increase is overdue:

State	Rate
Connecticut	$2.50 per barrel
Delaware	$2.00 per barrel
Maryland	3¢ per gallon, or 95¢ per barrel
New York	4-4/9¢ per gallon, or $1.38 per barrel
Pennsylvania	$2.48 per barrel

The Committee recommends:

a tax increase on beer to 10¢ per gallon. This modest increase would yield an estimated $9,600,000 in revenue.

TABLE 5-33
STATE OF NEW JERSEY
TAX REVENUE TRENDS OF ALCOHOLIC BEVERAGES
SELECTED YEARS, 1942-1971

Year	SPARKLING WINES	VERMOUTH	STILL WINES	LIQUOR	BEER
1971	$525,496.92	$115,042.23	$1,126.017.77	$37,202,432.94	$ 4,523,070.35
1970	410,752.07	115,014.07	992,719.29	36,453,120.38	4,480,545.74
1965	159,447.06	109,520.88	821,474.72	24,720,089.08	4,148,456.17
1960	91,703.51	89,569.09	740,917.59	16,509,681.00	3,978,858.11
1950	33,314.61	43,402.93	640,031.48	10,047,994.43	3,840,341.40
1942	20,409.71	26,112.13	560,679.67	7,163,497.70	3,094,520.95

Chapter XIV

The Cigarette Tax

Description

The cigarette tax in New Jersey is controlled by Chapter 40A of Title 54, Revised Statutes, and The Unfair Cigarette Sales Act of 1952, which is Section 56:7-18 of the Revised Statutes. The tax of 7¢ per ten cigarettes or fraction thereof is based upon the sale, use or possession for sale or use within the state of all cigarettes. In common usage, this means that each package of twenty cigarettes is taxed 14¢. The tax is administered in the Division of Taxation and is collected primarily from licensed distributors. "Distributor" is a term applying to any person who brings or causes to be brought into this state unstamped cigarettes which have been acquired from the manufacturer.

Collection

The cigarette tax is collected by the use of stamps which are purchased by distributors from the Bureau and affixed to each package. The Bureau allows a discount on purchases of 1,000 stamps or more. The New Jersey statutes specifically exclude cigarettes sold to the United States Government and its agencies and to hospitalized veterans in state hospitals. The statutes also allow for specific exemptions of cigarettes being transported to another state.

Revenue Trends

CIGARETTE TAX REVENUE COLLECTIONS

1971..	$123,804,999	1967..	$96,516,738
1970..	117,921,850	1966..	77,725,395
1969..	116,940,470	1965..	71,489,483
1968..	100,620,798	1964..	67,887,533
		1963..	61,046,006
		1962..	59,733,182
		1961..	47,297,977
		1960..	41,036,144
		1950..	18,009,703
		1948..	18,216,168

Cigarettes in recent years have been the subject of controversy due to the frequent health warnings issued by the Surgeon General's Office. These "health scares" do effect consumption in the short run, but this aberration in the demand pattern seems to taper off in the longer period. However, more serious consideration was given to the effect of rate increases on consumption. Statistics demonstrate that an increase in rate per pack seems to produce a diminishing increase in yield. This trend is not sufficient grounds to warrant the maintenance of this tax at its current rate.

The Committee recommends:

The cigarette tax should be raised to 18¢ per pack which is an increase of 4¢ per pack over the previous level. This increase would yield the state $30 million in revenue.

Chapter XV

Motor Fuel Tax

The New Jersey Motor Fuel Tax imposes a levy of 7¢ a gallon on motor fuels sold in the state; specifically the tax applies to "(1) any liquid or gaseous substance commonly or commercially known or sold as gasoline regardless of its classification or use; and (2) any liquid or gaseous substance used, offered for sale or sold for use, either alone or when mixed, blended, or compounded for the purpose of generating power for the propulsion of motor vehicles upon the public highways."

In 1971, revenues from the sale of gasoline totaled $200,146,469.78 with another $15,807,861 being realized from taxes on special fuels. With refunds and fines, the tax netted $210,255,461.92.

The Committee recommends:

So long as the current 7¢ rate is comparable with neighboring states it should not be changed, but certain modifications in the law are warranted in order to reduce administrative costs and simplify procedures.

One change pertains to the definition of "fuels", as found in Section 54:39-2 of the law. It is suggested that either subsection (b) be deleted in its entirety or that it be amended, striking out the phrase "... used as fuel in internal combustion engines" and replacing it with the words "used to propel motor vehicles upon the public highways."

The purpose of the change is to update the law to be consistent with certain technological changes within the petroleum industry. Furthermore, the current definition requires payment of the tax by aviation fuel purchasers who must then apply for a refund. This results in added costs to fuel dealers, the airlines and the state. The change in the law would alleviate this problem and correlate New Jersey law with Federal law as was previously the case. The Airport and Airway Revenue Act of 1970 repealed the same specifications still in New Jersey law, making taxabiliity of aviation fuels dependent upon end use of the product. The recommended changes to the state law would accomplish the same result without any foreseeable loss in revenue or administrative and enforcement controls.

In another area, the committee recommends a change in the regulations governing implementation and enforcement of the statute. Regulation 18:18-1c(1),(2) requires that a company must import 50% or more of its gasoline requirements in order to be eligible for a distributors license; this requirement is found in no state east of the Mississippi and its presence in New Jersey works to restrict distributors in their ability to make sales in the state. It is recommended that these sections be eliminated.

Chapter XVI

The Real Estate Transfer Tax

The Real Estate Transfer Tax, N.J.S.A. 46:15-5 *et seq.*, taxing transfers of real estate, was enacted in 1968 to replace the expired Federal levy on real estate transfers. Payment by the vendor of this tax is a prerequisite to the recording of the vendee's deed unless the transaction falls into one of seven exempt categories. Continuation of a levy based on the sales price of real property was deemed necessary to ensure a continued flow of sales price data to be used in determining assessment-price ratios. The tax, levied at the rate of 50¢ per $500 consideration, has provided revenue to defray county sales reporting costs, and has also provided additional funds for the use of county government which administers the tax.

While the Committee does not recommend changes in the Real Estate Transfer Tax, it does suggest further study to correct inequities. When property transferral is not subject to a mortgage, there is no tax. However, when property is subject to a mortgage, a tax is imposed, based on the amount of the mortgage.

Such transfers may occur between husband and wife, parents and a child, related corporate entities and other non-arm's length parties. Since substantial enjoyment of the property remains in the same hands, the persons benefiting from the property will be taxed again when they actually sell it. An unfair double taxation results.

Grants of easements, licenses, or deeds quieting title, raise a separate problem if the recording officers attempt to allocate the mortgage indebtedness affecting the entire parcel between the partial interest and the remainder of the fee. Such an attempt would probably cause disputes, because of the difficulty of allocation, would make desirable a redefinition of consideration for the purpose of these transfers, and an analysis of other problems of allocations involving indebtedness.

Chapter XVII

Pari-Mutuel and Gaming Revenues

In regard to pari-mutuel and gaming, the Committee has chosen to examine the revenue potential alone. The subject of gaming was explored from diverse points of view in a hearing held before the New Jersey Senate Judiciary Committee on December 8, 1970 in Trenton.

In its broadest context, the use of gaming revenues to support government involves policy decisions which go beyond taxation. Those who are in favor and those against the use of such revenues for State and local government are frequently at odds on philosophical, moral, or social grounds.

The Committee considered the following sources of such revenues:

1. Pari-Mutuel Betting
2. The State Lottery
3. Off-Track Betting (OTB)
4. Casino Gaming

Pari-Mutuel Betting

The State receives about $35,000,000 a year as its 17% share of pari-mutuel wagering conducted at four tracks in the State. Flat and/or harness racing meets are held under the auspices of five racing associations, the Monmouth Park Jockey Club, the Freehold Racing Association, the Garden State Racing Association, the Atlantic City Racing Association, and the Atlantic City Raceway Association. Due to an overlapping of racing dates, the 1972 racing season will total 380 days.

Considerable opportunity is currently provided to those persons who are interested in visiting existing facilities and wagering.

It is doubtful whether any more than nominal additional revenues can be provided from parimutuel betting. Neither a lengthening of the racing season, nor an additional number of tracks would necessarily be a step toward producing a greater yield. Rather, it may be expected that a lengthened season will spread even more thinly the supply of qualified racing entries currently available to tracks throughout the East. Indeed, the effect may be counterproductive.

Connecticut's move toward construction of new racing facilities will, indeed, increase the number of tracks in the area. This move cannot be expected to increase New Jersey's revenues.

State Lottery

New Jersey's success in operating a State lottery has been unique among the several states now operating one. Net revenues of $33.4 million were produced for the Treasury during the fiscal year 1971. On an annualized basis, the Lottery Commission is anticipating a 9% decrease for the current fiscal year and a further decrease of 7% in fiscal 1972-73. The basis for these projections is not unreasonable. First, the loss of the initial novelty of a lottery is expected to contribute to the decline. Secondly, Pennsylvania has initiated a lottery and New York has revised its machinery to follow more closely New Jersey's pattern. Both neighbors will be in direct competition for the scores of thousands of daily commuters exposed to ticket sellers of two state lotteries. Such competition can only be expected to have an adverse impact on New Jersey revenues.

The contribution of the lottery to the State's revenue sources has been welcome, but here again, as with pari-mutuel revenues, a forecast of any substantial expansion appears to be unrealistic.

Off-Track Betting

The current experience with New York City's Off-Track Betting Corporation is of course pertinent to any assessment of the revenue potential for New Jersey. The corporation has had less than a year's experience but projects a profit of $31 million for the fiscal year ending June 30, 1972.

Of this handle, 83% is allocated to cover bets. The remainder is divided: 5% to New York State; 0.5% to horsemen; 1.0% to the race track; 15% for profit and operating costs. Under 20% of New York OTB revenues are generated from New York State outside of the City. In December 1971, operating costs took 8.7% of the handle, but were being reduced, and the balance is profit to the city. By the end of 1971, OTB had 1,700 employees.

The rapid attainment of such magnitude of revenues is unquestionably spurred by physical circumstances peculiar to New York City. The very nature of Manhattan, with its high density pedestrian traffic, has enabled OTB to establish 36 betting offices accessible to this market. The convenience of these locations is undoubtedly a major factor in OTB's achievement of its present revenues. Few cities in the world can rival New York City in providing such a number of prime locations to so many customers.

There are indications that a majority of OTB customers are above average in socio-economic status and include a substantial portion of single people. The conclusion drawn is that a greater per capita availability of disposable income exists in this group. Contrariwise, heavy OTB bettors, who account for the greater portion of the wagered dollars, are somewhat lower in socio-economic class.

Both groups, as well as the majority of OTB customers, are experienced bettors. New York statistics seem to project that a percentage of bettors as high as 90% fall in this class. At the same time, it is generally presumed that less than 10% of the general public may be called experienced bettors.

The fact that most OTB bettors are experienced suggests that revenues gained from their participation in OTB would conceivably be at the expense of pari-mutuel revenues, as there is little evidence to intimate that a new segment of persons with high disposable incomes have been attracted and are now participating. Some indication exists that a reasonable proportion of participants in OTB have also placed bets with bookies. This, perhaps, hints that the total betting market may not have increased in New York due to OTB, but that some siphoning of betting funds previously placed with bookies can be expected. The extent to which these funds are attracted to OTB may give a clue as to the ultimate outcome for OTB.

An OTB operation in New Jersey would lack the obvious benefits of being astride the daily high density traffic pattern available in New York City.

The revenue potential for OTB in New Jersey, therefore, appears to be considerably less than for New York City.

A special study to determine the feasibility and revenue potential of OTB for New Jersey might disclose whether the socio-economic conditions peculiar to New Jersey warrant further consideration of OTB.

Casino Gaming

Casino gaming may be classified into roughly two groups. The Las Vegas and Reno gambling areas are one type. This Nevada structure is unique.

The atmosphere of the other type of structure, in contrast, is not flamboyant. Most of the gaming rooms in other parts of the world are confined to large hotels, and the hours and dress of clients are strictly regulated. In London, private clubs are licensed with one or more gaming rooms in each. Monaco has one large casino of renown. In both France and Germany, casinos exist in resort cities, and as such, provide one form of evening entertainment, no more obvious and ostentatious than any other. The Caribbean gambling areas are also usually confined to the large hotels.

The subject of casino gambling was reviewed by the New Jersey Legislature in 1971. In spite of the volume of data collected, substantial uncertainty as to the revenue potential still exists. Even if it could be assumed that a New Jersey strip of the Nevada type were to be as successful a revenue contributor to New Jersey State revenues as the Nevada operations are to Nevada, and that not more than ten years would be required to develop the area, the revenue to New Jersey could amount to $39,000,000. The Nevada Gaming Commission collections were reported in the fiscal year of 1970 to be $39,260,218.75. Of this $39.3 million, $27.5 million comes from percentage fees on gross revenue, $6 million from entertainment taxes, and $5.8 million represents penalties, investigative fees, and other special levies. In 1970, 1,026 licenses embracing 36,054 licensed gaming devices were in force in Nevada.

Another study presented to the Committee at a public hearing held in Trenton on May 26, 1971 included a projection fourteen years ahead to 1985 estimating net collections to the State in the wide range of $24 million to $72 million by then, *if* regulated casino gaming were in operation today.

It is clear, based on the revenue and expenditure projections of the Committee, that while any revenues from casino gaming would contribute some monies to the State, the amounts generated would be small in proportion to the needs. The very unpredictability of the amount does not allow the construction of a solid fiscal base on which the State should rely.

Summary

The prospect of achieving an increase in pari-mutuel and lottery revenues appears to be slight. The prospect of achieving meaningful collections from OTB is unclear. The prospect of achieving meaningful revenues from casino gaming lies far in the future.

Thousands of New Jersey homeowners and property taxpayers will be in even more dire circumstances than now if the State relies on developing additional gaming revenues to provide the State's immediate needs, rather than relying on tested sources of revenue.

The Connecticut State Revenue Task Force in its findings reported in February 1971 declined to recommend gambling as a revenue source. Its focus for objection was on the indefinite and speculative nature of potential revenue to be derived therefrom.

While the Off-Track Betting Commission in New York State itself has recommended that a constitutional amendment for permitting legalized casino gaming be submitted to its citizens, Governor Rockefeller has not indicated enthusiasm for the idea because, generally, legalized gambling provided only a "pittance" to government.

The Committee concludes:

It is clear that, even the most optimistic projections of revenues from all gaming which have been put forth, cannot and will not solve the State's revenue problems, and accordingly, cannot be relied on to do so.

The revenue potential from other forms of gambling do not readily appear to be commensurate with the difficulties of administration and the costs of policing. Throughout history no successful methods have been devised to capture revenues for any jurisdiction from illegal gambling.

In order not to overlook potential sources of revenue not in conflict with public policy, the subject of gambling and gambling revenues might be reviewed by a study group authorized to probe thoroughly all of the issues and revenue prospects.

SECTION E – FUTURE EFFECTS ON FURTHER NEEDS

Chapter XVIII

Combined Effect of Revenue Recommendations

The Committee's recommendations for the adoption of non-property tax revenues sufficient to assure the elimination of the projected fiscal gaps for 1975 and 1980, and to permit the massive property tax reductions recommended by the Committee, to be implemented primarily through the recommendations of Part II and Part III of the Report, may be summarized as shown in Table 5-34.

The effect of these revenue recommendations overall has been tested to determine their influence upon the distribution of the tax burden of the state-local revenue system, as compared with the present system described in Part I of the Report. These tests include measures of effective tax rates, progressivity and income elasticity of the restructured tax system.

Effective Tax Rates. The correction of the past pattern of regressivity in the incidence of New Jersey taxes as shown by their "effective tax rates" is a notable accomplishment of the new system, demonstrated in Table 5-35.

Progressivity. The progressivity indices for the present system and the proposed restructured system are shown in Table 5-36. Again the table demonstrates that the recommended restructuring will convert a regressive tax system into a proportional tax system, which is something few states can boast about.

Income Elasticity. It is not possible to project the income elasticity of the new system in the same terms as were used for the existing system, for lack of adequate historical data of the system that is proposed. In lieu of the approach used for the present system, however, it is possible to assess the income elasticity from the changes in the recommendations. As compared with an income elasticity of the entire present state revenue system of .98 (see Part I, Table 9) the corporate income tax had an income elasticity index of 1.49 and the sales tax 1.44. Both of these sources are emphasized in the recommendations. In addition, the extreme income elasticity of the proposed income tax is evident from its progressivity index of 2.40. The combined effect of adding $867.5 million from these highly income elastic sources to the present state revenues of $1.6 billion is certain to increase greatly the income elasticity of total state revenues, due to the weight that the new sources will have as a percentage of the total.

The increase in the progressivity index of the total system from .72 to .93 also indicates greatly increased elasticity of the total system. While the progressivity index is computed as of one point in time, and the elasticity index is a measure of the yield over time, an increase in the progressivity index by 30% may well indicate that the income elasticity index will increase at least that much, especially in light of the sources of new money.

This means an income elasticity index of state revenues may be predicted upwards of 1.30, thus practically closing the previous gap between this index and the income elasticity of expenditures. As the two indices of income elasticity come together, the recurring financial crises in the state budget process will be minimized if not avoided entirely.

TABLE 5-34

STATE OF NEW JERSEY

ESTIMATED NET ADDITIONAL REVENUE EFFECTS OF PROPOSED TAX LAW CHANGES

	$ (Millions)
ABC	
Liquor	0
Wine	1.0
Beer	9.6
Cigarettes	30.0
Financial Business Tax, Other Than Commercial Banks	2.0
Sales Tax	237.55
Personal Income Tax	550.00
Corporation Business Tax	90.0
Business Personal Property Tax	27.5
Retail Gross Receipts Tax & Unincorporated Business Tax	—21.6
Transfer & Inheritance Tax	0
Total Estimated Net Additional Revenue	926.1

TABLE 5-35

STATE OF NEW JERSEY

COMPARATIVE EFFECTIVE TAX RATES BY INCOME CLASSES UNDER THE COMMITTEE'S RECOMMENDATIONS AND THE PRESENT REVENUE SYSTEM

(In % without offsets for federal income tax deductions)

Item	Under $3,000	$3,000 to $5,000	$5,000 to $7,500	$7,500 to $10,000	$10,000 to $15,000	$15,000 to $25,000	$25,000 and Over
Old Structure							
No offsets except exporting to out-of-state stockholders, etc.*	20.3	16.9	15.2	13.6	12.9	11.5	7.2
Recommended							
New Structure Without Sales Tax Changes	14.8	13.6	12.9	12.8	12.1	11.8	11.7
With all Changes	15.8	14.4	13.4	13.9	13.2	12.8	12.3

* These rates are the "state-local taxes plus federal individual income taxes" shown in Part I, Table 21, less the "federal individual income taxes" shown in the same table.

TABLE 5-36

STATE OF NEW JERSEY

COMPARATIVE PROGRESSIVITY INDICES OF THE PRESENT TAX SYSTEM AND THE RECOMMENDED TAX SYSTEM

	Unweighted Progressivity Index	Weighted Progressivity Index
Old structure with sales tax at $520 million	.69	.72
Old structure with sales tax changes recommended	.71	.73
Recommended new structure without changes in sales tax	.93	.92
Recommended new structure including sales tax changes	.93	.93

Chapter XIX

Reform of Administrative Procedure and Review of State and Local Taxation

Simplification and Standardization of Tax Procedures:

Meaningful tax reform cannot be accomplished without a thorough going revision of the myriad of procedural rules which govern the assessment, collection and review of the many taxes which make up New Jersey's system of State and local taxation. The existing procedural maze has grown year by year and tax by tax without consistency or reason. Only the most adept tax practitioners can thread their way through these procedural barriers with any confidence.

Tax returns, refund claims, statute of limitations, lien provisions, and interest and penalties are some of the provisions that should be standardized. Indeed, the New Jersey tax statutes contain a Uniform Tax Procedure Act (N.J.S.A. 54:48-1 et seq.) which sits astride the morass, largely ignored because of the legislative tendency to include procedural rules in every new tax statute.

New Jersey's system of tax procedure and review, initially devised in a bygone era when the level of taxation was less severe, must be simplified, standardized and updated to provide an understandable and workable body of rules applicable, in general, to all of the taxes of New Jersey.

The Committee recommends that:

1. The revision of the taxing statutes of New Jersey for the purpose of collecting and restating in one place all of the general procedural requirements and provisions so as to avoid inconsistency and redundancy.

2. A ruling section be established with the Division of Taxation to provide advance rulings to taxpayers in a manner similar to the issuance of rulings by the Internal Revenue Service.

3. That a study be made to devise a tax form package for small business which would include simplified short forms of tax returns which would for a given business all be due on the same date, in order to minimize the inconvenience and expense of multi-returns for the small businessman.

Simplification and standardization of Tax Review and Appeal Procedures:

The taxpayers right to contest the imposition of tax as it now exists is a path strewn with obstacles that are overcome only by the most pertinent litigant. There are no established procedures for informal review within the Department of the Treasury. There is no authority within the Department to compromise tax claims. Formal administrative review is to the Division of Tax Appeals, a body which itself lies within the Department of the Treasury, which is subject both to pressures from the Department, but also to other pressures by reason of the fact that its seven members bear the title "judge" but are on a part time basis and may freely engage in the private practice of law. Taxpayers are currently denied the right to have their cases heard at the trial level in a forum having the status, prestige, experience and demeanor of a judicial court. Under the present system to receive a fully judicial review, a taxpayer has resort only to costly appeal to the Appellate Division of the Superior Court.

The Division of Tax Appeals in the Department of the Treasury presently exercises trial jurisdiction with respect to all tax matters except those relating to the Transfer Inheritance Tax. Inheritance tax matters were excepted from the jurisdiction of this body many years ago so that the members of the Division of Tax Appeals would not be barred from handling estate matters in their private law offices. Whatever the reason, this exception results in the awkward system of having such matters heard initially by the Appellate Division of the Superior Court. Many Transfer Inheritance Tax cases involve questions of fact, for instance, the question of whether a gift was made in contemplation of death. The Appellate Division has no facilities for exercising trial level jurisdiction, yet these cases may involve testimony and cross-examination of witnesses which can adequately be handled only at the trial level. In addition, the expense of pursuing an appeal to the Appellate Division effectively deters most claimants from seeking judicial review.

There is no body of written decisions of the Division of Tax Appeals which may be relied upon to guide taxpayers and tax administrators. The proceedings are often delayed unduly by crowded dockets and voluminous calendars.

Disputes concerning taxes frequently involve substantial sums of money and important legal issues. If an income tax is enacted these sums and issues will become more frequent, and their disposition in a judicial atmosphere will become more important both to the taxpayer and the State.

The need for a judicial tax court with full time judges has been urged by two recent legislative commissions (See page 36 of the Field Report and pages 44-46 of the Apy Report). Such a Tax Court would be removed from politics and would have the time, expertise and temperament to afford speedy and relatively inexpensive relief to all taxpayers. The Section of Taxation of the American Bar Association in Volume 24 No. 4 of the Tax Lawyer has stated, "The goal of tax litigation procedure should be to provide the taxpayer with a determination of his tax liability at the least cost to the taxpayer and the State by a tribunal which not only is, but which the taxpayer believes is, completely impartial." The American Bar Association has recommended the establishment of a fully judicial tax court with plenary jurisdiction, hearing cases de novo without a jury with both a regular and small claims division.

The New Jersey State Bar Association has similarly recommended the creation of a tax court as opposed to an administrative agency. Administrative agencies, as an arm of the executive branch of the government, do not instill the same public confidence. Most people believe that courts protect the citizen but the concern of an administrative agency is the functioning of the governmental system.

The New Jersey State Bar Association has suggested that the tax court be created as an inferior court, having an organization and provisions similar to the County District Court or the Juvenile and Domestic Relations Court but operating on a statewide basis. A draft of a suitable enabling statute has been proposed by the New Jersey State Bar Association.

The recommendations with respect to the administration of the property tax in part 2 of this report include the establishment of a tax court. These recommendations incorporate the utilization of existing county tax boards as quasi judicial agencies for the purpose of screening appeals. Appeals might ultimately go to the Tax Court by way of the Small Claims section, if applicable. Review is therefore allowed for property tax matters at the local level to provide speedy, practical relief. Matters involving an amount greater than $100,000 would be handled directly by the Tax Court.

For all taxes other than the property tax the procedure allows a direct appeal to the Tax Court, through the Small Claims section if applicable, from the administrative agency of the Division of Taxation, again in much the same manner that appeals from IRS rulings are handled federally.

Initial judicial review is provided by the same Tax Court for both property and non-property tax matters.

The Committee recommends:

1. Review of all tax disputes, both property and non-property, at the trial level by a Tax Court in the Judicial Branch of state government which has full time judges.

2. The creation of a Small Claims section of the Tax Court in which informal procedures are used to provide speedy and inexpensive relief to taxpayers making claims involving less than $2000 in tax.

3. Review within the Division of Taxation of the Department of the Treasury of all matters within its jurisdiction patterned along the lines of the Appellate Division within the Internal Revenue Service, with the right to compromise a tax.

Recommendations for a Continuing Study of the New Jersey Tax Structure

The Tax Policy Committee has been able to view the broad scope of the system of taxation in New Jersey. From its studies and vantage point many details and tax topics were uncovered which the Committee suggests are timely and worthy of further serious attention. In the dismemberment of its operations the Committee foresees an undesirable discontinuity and wasteful loss of momentum. To maintain present records, resources, expertise and continuity it recommends the creation of a permanent committee in order to probe more thoroughly on an on-going basis such tax subjects as:

1. Taxation of insurance.
2. Taxation of banks and other financial institutions.
3. Unincorporated business income.
4. Realty transfer tax.
5. Real and personal property taxes.
6. Environmental aspects of taxes.
7. Tax treatment of open spaces.
8. Inequities in State non-tax revenue sources.

9. The effects of tax law revisions on the State.
10. Continuing surveillance of the effect of other programs of the report.
11. Special industries apportionment formula and taxing procedures.

The Committee has seen, through its many days of meetings and work together the advantages of having the representation of many diverse interests. The continuation of a group composed of members whose talents range through the entire spectrum as to experience, political philosophy and ideals assures that a consensus when reached has the interests of the State and its citizens as its goal. A good foundation for further study has been established. Some members of the present committee might be invoked to serve as a cadre and to maintain a useful degree of continuity.

Even the job of supervising the needed revisions of the New Jersey tax statutes could well be treated under the aegis of this committee. The taxing statutes in New Jersey, as in many states, are a conglomeration of legislation resulting from historical accidents and should be consolidated and clarified. The effecting of economies through consolidation of taxing agencies is suggested as another subject which might yield fruitful benefits under the supervision of the Committee.