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A comparison of the Massachusetts corporate tax with that of twelve other industrial states.

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A Comparison of the Massachusetts
Corporate Tax With That of
Twelve Other Industrial States

by

Edwin Sumner Katzman

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INTRODUCTION

My major objective in pursuing this study has been to criticize the current Massachusetts Excise Tax and its over-burdening effect upon the business climate of Massachusetts.

In particular, I have felt that the corporate excess feature of the tax (explained more fully in the text) has some rather severe aspects to it. For example, even though a Massachusetts corporation suffers a loss, it must pay, in addition to city real estate taxes, a tax on tangibles such as cash, inventories, accounts receivable, investments, machinery and other assets not locally taxed. This latter tax I feel is extremely objectionable, for in a corporation requiring a large inventory or large amounts of machinery the corporate excess tax whose rates are five dollars per one thousand dollars, plus a twenty-three per cent surtax, further irritate a loss which may be already weakening the corporation.

With the economic dependence of Massachusetts on industrial strength and diversification, coupled with its past decade losses of the textile industry to states with milder tax provisions, it is imperative that Massachusetts heed the perils of its corporate excess tax or suffer the continuing loss of industry to the State.

To form a basis urging discontinuance or alteration of this corporate excess tax I have selected twelve other States whose economic welfare depends upon industry and mining as contrasted with those dependent primarily on farming as the core of their economy. By illustrating the effect of each state's tax upon a basic set of corporate facts, I hope to make clear the high rate at which Massachusetts corporations are taxed on incomes as well as the high rate used in calculating the corporate excess portion of the tax.

In contrast to this, advocates of the Massachusetts Sales Tax, which has as one of its purposes the reduction of local property taxes, foresee the need for higher taxes to offset the current State budget which calls for increasing expenditures. I strongly urge the State Legislature not to consider increases in corporation taxes as one means of alleviating this deficit.

High property taxes, high corporate taxes, and increased spending by State agencies aggravate the existence of corporate entities in this State. To explain the procedures which other states are using successfully, I have compiled and reviewed the subsequent data.

Table I. Comparative Taxes in the Various States

State	Tax	Rate and Measure	Tax for Example Corporation
Massachusetts	Corporation Excise Tax	5½% of net income earned in Mass. and \$5.00 per \$1,000 of corporate excess plus 23% surtax	\$3,216.00
North Carolina	General Income Tax	6% of net income allocated to North Carolina	1,500.00
	Corporation Franchise Tax	\$1.50 per \$1,000 of capital (net worth) allocable to North Carolina.	665.00
		10¢ per \$100 of money on deposit; 25¢ per \$100 on all other tangibles	258.00
			\$2,423.00
Pennsylvania	Corporation Income Tax	6% of net income allocated to Pennsylvania	1,303.50
	Capital Stock Tax	5 mills per \$1.00 of capital stock apportioned to Pennsylvania	2,125.00
			3,428.50
New York	Business Corporation Franchise Tax	5½% of net income allocated to New York on \$1.00 per \$1,000 of capital allocated to New York	1,191.00
Connecticut	Corporation Business Tax	3% of net income allocated to Connecticut on 1½ mills per \$1 of capital (net worth) and bonded debt in Connecticut	769.00
New Jersey	Corporation Franchise Tax	8/10 mill per \$1.00 of net worth allocated to New Jersey	356.00

Table I. Comparative Taxes in the Various States (cont.)

State	Tax	Rate and Measure	Tax for Example Corporation
Michigan	Corporation Business Tax	$2\frac{1}{2}$ mills per $1.00 of contributed capital and retained earnings representing property in Michigan	$1,112.00
	Intangibles Tax	Greater of 3% of income from intangibles or 1/10 of 1% of their face, par, or contributed value less credit of $20.00 except money and deposits taxed at 1/25 of 1%	75.00
			$1,187.00
Indiana	Gross Income Tax	1/2 of 1% of manufacturing and wholesale prices within Indiana 3/8 of 1% of retail sales within Indiana	$1,537.00
	Intangibles Tax	5¢ per $20.00 upon full or actual value of intangible property except shares and deposits in banks and trust companies and shares in Building and Loan Associations	62.00
			1,599.00
South Carolina	Gross Income Tax	Generally, 5% of net income (see Chapter II)	$1,410.00
Alaska	Corp. Income Tax	18% of the Federal Tax liability	$1,082.00
	Business License Return	Based on net sales. (see Chapter II)	1,650.00
			$2,732.00
California	Bank and Corp. Franchise Tax	4% of net income allocated to California	919.48
Florida and Illinois	Both states have no state taxes on corporate net income but they do have capital stock taxes which in each state are less than $500.00 and are not included in this table.		

Table I. Comparative Taxes in the Various States (cont.)

State taxes which are used in the comparison of this report are shown in the above table, together with the estimated amount of taxes payable under each tax measure by a hypothetical corporation described in Table II. It should be emphasized, however, that the example comparison relates to a single corporation and is therefore conditioned entirely by the way the tax structures of the several states react to this particular set of corporate facts.

Table II. Example Corporation Balance Sheet and Operating Statement

BALANCE SHEET

ASSETS		LIABILITIES	
Tangible property, including inventory within the state	$350,000.00	Accounts Payable	$ 80,000.00
Tangible property, including inventory out of state	50,000.00	Notes Payable	100,000.00
	$400,000.00		$180,000.00
Cash (deposits) within state	$ 50,000.00		
Shares of stock in domestic corporations	50,000.00		
Shares of stock in foreign corporations	25,000.00		
	$125,000.00		
		Net Worth:	
Receivables with situs in state	$125,000.00	Capital Stock	$300,000.00
Receivables with situs out of state	25,000.00	Amount paid in excess of par value	50,000.00
Other assets	5,000.00	Retained Earnings	150,000.00
	$155,000.00		$500,000.00
Total Assets	$680,000.00	Total Liabilities and Net Worth	$680,000.00

Table II. Example Corporation Balance Sheet and Operating Statement (cont.)

OPERATING STATEMENT

Gross Sales		$600,000.00
Cost of Manufacturing and Selling		524,000.00
		76,000.00
Interest Income		2,000.00
Income from Dividends		1,000.00
Total Income		79,000.00
Rents Paid	$15,000.00	
Interest Paid	3,000.00	
Depreciation Charged	15,000.00	
Taxes Paid (Deductible for Purposes of Federal tax)	20,000.00	53,000.00
Net Income		$ 26,000.00

Detail of Sales:

Sales from Home Office Within the State	$300,000.00	
Out of State Sales from Home Office	200,000.00	
Out of State Sales from Out of State Office	100,000.00	
Total Sales		$600,000.00

Detail of Payrolls:

Payrolls within State	270,000.00	
Payrolls outside State	30,000.00	
Total Payrolls		$300,000.00

CHAPTER I

MASSACHUSETTS

Nature and History of the Corporation Excise Tax*

Domestic and foreign business and manufacturing corporations are subject to local taxation on the assessed value of their real estate, including poles, underground conduits, wires, and pipes. Personal property of manufacturing corporations, including both merchandise inventories and machinery, is exempt from local taxation. Machinery "used in the conduct of business" by domestic or foreign corporations, not classified by the Commissioner as manufacturing, is subject to local taxation. All domestic and foreign corporations not exempt or otherwise taxed are subject to an excise tax which includes the sum of (1) a tax at the rate of $5.00 per $1,000 on the "corporate excess" (or on the value of exempt tangible personal property, whichever is the greater), and (2) a tax at the rate of $5\frac{1}{2}$ per cent on the corporate net income before federal taxes.#

To understand this present system of taxing corporations in the Commonwealth it is essential to consider its long history, which began in pre-Civil War days and carried through 1936 when the present method of exempting the machinery of manufacturing corporations from local taxation was adopted. In Massachusetts, as in other states, corporate taxation began by the taxation of the corporate shares in the hands of stockholders as part of the general property tax. The idea that it was double taxation to tax shares of stock to the shareholders and also to tax the property of

* 9, pp. 1-4.

\# These rates exclude the surtax which is currently an additional 23% of the tax.

the corporation was readily accepted by the courts before the modern development of the corporate enterprise. But unlike most other states, the Massachusetts courts construed the early statutes in 1813 as exempting the personal property of domestic corporations rather than exempting shares in the hands of the individual shareholders. Contrary to the policy adopted a century later, machinery was by statute specifically made taxable to the corporations in 1832, and it was then provided that in local assessment of the shares of a manufacturing corporation the value of the machinery locally taxed should be deducted.

The present excise tax may be traced to 1864. In the form of an excise tax upon the franchise of domestic corporations, legislation of that year levied a tax at the state average of local property tax rates on the market value of each corporation's capital stock in excess of the value of the corporation's real estate and machinery situated in the State and locally taxed. Shares in domestic corporations owned by residents of the Commonwealth were no longer to be taxed locally. The personal property of the corporation other than machinery, which had previously been exempt, continued to be exempt. Subsequently, other legislation provided for additional deductions from the value of corporate excess and sought to place a maximum limit on the amount of the tax. In 1917 a joint legislative committee recommended that the tax on franchise value be discarded and that an income measure be substituted, but this recommendation was not accepted. It was not until 1919 that the corporation excise tax was revised and given its present form; a combination of the old franchise tax in the form of a levy at $5.00 per $1,000 on corporate excess plus a new levy at the rate of 2½ per cent on corporate income. In general, since 1919 foreign corporations have been taxed according to the same system as domestic corporations.#

The last major characteristic of the present tax system to be adopted became law in 1936, when machinery of manufacturing corporations was exempted from the local property tax. The value of such machinery then became no longer deductible in calculating the corporate excess, and was included in an alternative minimum tax base of tangibles not locally taxable, and taxed at the uniform rate of $5.00 per $1,000. Meanwhile, in 1928, the excise tax on motor vehicles was adopted, so as to take this class of personal property out of the administration of the general property tax. But the principle of taxation for local use was retained, and the assessed value of motor vehicles accordingly remained deductible for corporate excess purposes.

Including three alternative minimums the present tax on domestic and foreign corporations not exempt or otherwise taxed (General Laws, Chapter 63, Sections 30 to 52, as amended), the present law may be expressed in outline form as follows:

> $5.00 per $1,000 on "corporate excess" or on Massachusetts tangibles not locally taxable - whichever is greater - plus $5\frac{1}{2}$ per cent on net income before Federal taxes.
>
> or
>
> 1/20 of 1 per cent of Massachusetts gross receipts plus 3 per cent of net income
>
> or

Acts of 1919, Chapter 355, effective January 1, 1920.

1/20 of 1 per cent of the value of the capital stock plus
3 per cent of net income

or

a minimum tax of $25.00, whichever is greater, plus a
23 per cent surtax.

The Basis and Rates of the Corporation Excise Tax*

The corporation excise tax is all-inclusive, and applies to all domestic and foreign corporations, except for relatively few classes of corporations which are either exempt or otherwise taxed. Domestic business and manufacturing corporations are subject to the excise tax by reason of their "corporate existence at any time within the taxable year," and foreign corporations are subject to the tax "with respect to the carrying on or doing business within the Commonwealth". Except for this difference in taxable status, there are few basic differences in the treatment of domestic and foreign corporations under the tax law.

The corporation excise tax, as already explained, reaches both capital and net income of corporations. The corporate excess part of the tax is payable by net loss as well as net income corporations. But two factors have operated to make the net income measure of the corporation excise tax the major part of the tax. First, there has been a series of increases in the tax rate applied to corporate net income; and secondly, the great growth in the economy which has contributed to corporate profits has greatly expanded the measure of the net income tax. The effective

*9, pp. 4-6

rate at which corporate income is currently taxed is 6.765 per cent, computed as follows:

1. A tax of $2\frac{1}{2}$ per cent on net income. - This is a permanent tax and its proceeds, along with the money received from the corporate excess tax, is distributed 5/6 to the cities and towns and 1/6 to the General Fund.
2. A temporary additional tax of $1\frac{1}{2}$ per cent on net income, the proceeds of which go into the General Fund.
3. A temporary additional tax of $1\frac{1}{2}$ per cent on net income, the proceeds of which are paid into the Old Age Assistance Fund.
4. A surtax of 20 per cent on the above taxes, its proceeds to go into the General Fund.
5. A surtax of 3 per cent on the same taxes as the 20 per cent surtax - this tax is permanent. Its proceeds go to the Old Age Assistance Fund.

Massachusetts is the only state in the nation, other than Pennsylvania, which requires corporations to pay both a State net income tax and a high-rate State tax on capital values. In addition to the income tax measure, the corporate excess measure of $5.00 per $1,000 may impose a substantial burden upon many businesses. The above rates on net income, therefore, do not show the effective tax rate that the corporation excise tax imposes upon corporate income. This effective rate can be expressed in terms of the relationship between the total amount of the corporation excise tax (including both net income and corporate excess parts) to the net income of corporations allocated to Massachusetts.

Both the established rate on net income and the effective rate of the total corporation excise tax on corporate net income are high when compared with other states.

Only three other States - Oregon, Idaho and Wisconsin - apply higher corporation income tax rates than the 6.765 per cent established rate in Massachusetts. However, two of these states allow a deduction of all or part of the Federal income tax from taxable income, while Massachusetts allows no such deduction. Oregon applies a flat 8 per cent tax rate without deduction for Federal taxes, but allows credit for personal property taxes paid by taxable corporations up to 50 per cent of their income tax.# The average effective tax rate upon corporation income in Oregon was 6.48 per cent in 1947. Idaho reaches 8 per cent on corporation incomes in excess of $5,000 in a graduated rate structure, but allows deduction of Federal taxes from the State tax base. The present Federal tax rate of 52 per cent upon corporate incomes of most corporations means the deduction of Federal taxes reduces the effective maximum rate of the Idaho tax from 8 per cent to about 3.84 per cent upon the Massachusetts basis of income before Federal taxes. In the same way Wisconsin reaches 7 per cent on incomes in excess of $6,000, but allows deduction of Federal taxes up to 10 per cent of income so that the effective maximum rate upon income before Federal taxes is about 6.3 per cent.

The conclusion is warranted that the effective rate of the net income measure of the corporation excise tax in Massachusetts is now higher

In July, 1957, Oregon decreased the corporation excise tax rate from 8 per cent to 6 per cent for corporations subject to the regular income tax.

than that imposed in any other State (except possibly Oregon), and when the amount of the corporate excess measure is added, the effective rate of the corporation excise tax upon net corporate income is beyond question higher than the comparable burden imposed in any other State except Pennsylvania where the combined income tax and capital stock tax exceeds the Massachusetts corporation excise tax.

In Massachusetts net income is defined as gross income from all sources, without exclusion, but less the deductions allowable by the Federal Revenue Act applicable for the taxable year except that

1. No dividends received deduction is allowed;*
2. Losses sustained in years other than the taxable year are not allowable.

This eliminates capital loss carry-overs as well as net operation loss carry-overs and carry-backs, but does not prevent the deduction of a charitable contribution carry-over.

The corporate excess of a corporation is the fair value of the capital stock less certain specified deductions, on the last day of the taxable year. The portion of the corporation excise based on this factor is computed at $5.00 per $1,000 of the corporate excess, and to this result is added the 23 per cent surtax. There is not and never has been any provision for the proration of corporate excess, or the tax based thereon, in the case of a short taxable year. Such a proration would seem equitable.

The fair value of capital stock is converted to taxable corporate excess by reducing it by the following deductions at actual values on the last day of the taxable year.

*1, pp. 1-31

Deductions:

(1) Massachusetts tangible property subject to local taxation, i.e., the equity in Massachusetts real estate, the full value of Massachusetts tangible personal property locally taxed, and the full value of motor vehicles and trailers registered in Massachusetts. (The assessed values are considered as the actual values.)

(2) Nontaxable securities, i.e., the full value of securities the income from which would not be subject to Massachusetts personal income tax if owned by a resident individual.

(3) Tangible property situated outside Massachusetts, i.e., the equity in such property.

(4) Cash and accounts and bills receivable attributable to an office outside Massachusetts.

It is at this point that the distinction between business and manufacturing corporations has the greatest effect. Since the machinery of business corporations "used in the conduct of business" is subject to local taxation, it is deductible in arriving at corporate excess. The machinery of manufacturing corporations, not being subject to local taxation, is not deductible and hence is in effect taxed as part of the corporate excess at $5.00 per $1,000 (plus 23% surtax). Because the total rate of tax on corporate excess is much less than the rates at which local property taxes are levied, it is generally desirable for a corporation having a substantial amount of machinery to be classified as a manufacturing corporation.

There is one more point that must be explained before going on. To determine corporate excess the valuation of the capital stock must be ascertained. The valuation of the capital stock of a domestic business or manufacturing corporation, or a foreign business or manufacturing corporation doing business in Massachusetts, for the purpose of determining Massachusetts corporation excise liability should be computed in the following manner according to the current ruling:

If the capital stock of a corporation is not traded on a security exchange, and the officers, in the aggregate, do not own, directly or indirectly, fifty per cent (50%) or more of the voting stock of the corporation, the value of the capital stock for excise liability should be computed as follows:

1. From the total book assets, there should be deducted the liabilities. The amount so determined should be termed "Net book asset value".
2. The book earnings averaged for the last five taxable years should be capitalized at 10%. The amount so determined should be termed "Average earnings capitalized". If the average book earnings figure shows a net loss it should be entered as zero.
3. The "Net book asset value" should be multiplied by two; the "Average earnings capitalized" by one; and the total divided by three. The amount so determined should be termed "Computed value using earnings".
4. If the "Computed value using earnings" exceeds the "Net book asset value" (i.e., if (3) exceeds (1), the "Computed value using earnings", (3) shall be used as the value of the capital stock for determining

excise liability.

5. If the "Computed value using earnings" exceeds the "Net book asset value" the value of the capital stock is the highest of the following three amounts:
   (a) Eighty per cent (80%) of "Net book asset value", or
   (b) The "Net book asset value" reduced by twenty-five per cent (25%) of the value of fixed assets not subject to local taxation, or
   (c) The "Computed value using earnings". (Formula Method)

Such amount (i.e. the highest of 5(a), or 5(b), or 5(c), is the value of the capital stock for the excise liability. In the "Formula Method" (c) when corporate officers own 50 per cent or more of the stock and it is actively traded in security markets, the market value of the shares enters into the computations. When the stock is owned by the officers to the extent of 50 per cent or more and the stock is not actively traded, compensation paid to these officers enters into the computations. For the purposes of simplicity the above formula which is outlined has been used in our sample corporation.

Referring to our sample corporation balance sheet and profit and loss statement, the following calculation of Massachusetts excise taxes follows the formula just explained.

Computation of Massachusetts Corporate Excise Tax

Net Income	$ 26,000.00
Less-Dividends and Interest	3,000.00
Income Subject to Allocation	23,000.00
Portion Allocated to Massachusetts	86.9%
Income Allocated to Massachusetts	19,987.00
Add-Back Interest and Dividends which are not Subject to Allocation	3,000.00
Net Income Taxable	22,987.00
Tax Rate (5.5% plus 23% Surtax)	.06765
Total Income Tax	$ 1,555.07

Allocation Factors:	Total	Massachusetts	Per Cent
Tangible Property	$400,000.00	$350,000.00	87.5
Payrolls	300,000.00	270,000.00	90.0
Gross Receipts (Sales)	600,000.00	500,000.00	83.3
Average Percentage			86.9

The Tax on Corporate Excess is Computed as Follows:

First Value of Capital Stock:	
Net Assets (Net Worth)	$500,000.00
Less-Securities	75,000.00
Net Assets Less Securities	425,000.00
Percentage (Depending upon Ratio of Fixed Assets to Net Assets Less Securities)	80%
	340,000.00
Add-Securities	75,000.00
First Value of Capital Stock	$415,000.00
Second Value of Capital Stock:	
Net Assets less Securities x 2	$850,000.00
Average (current) Earnings x 10	260,000.00
Total	1,110,000.00
Divide by 3	370,000.00
Add-Securities	75,000.00
Second Value of Capital Stock	$445,000.00

Larger of Two Values of Capital Stock (2nd) $445,000.00

Less-Deductions:	
Equity in Massachusetts Real Estate (assumed)	$100,000.00
Tangible Property Outside Massachusetts	50,000.00
Intangible Property Outside Massachusetts	25,000.00
	$175,000.00

Computation of Massachusetts Corporate Excise Tax (cont.)

Value of Capital Stock for Corporate Excess Purposes	$445,000.00
Less-Deductions	175,000.00
Corporate Excess Tax Base	270,000.00
Tax Rate ($5.00 per $1,000 plus 23% surtax)	.00615
Corporate Excess Tax	$ 1,660.50

Note: - This tax applies because the corporate excess tax base is greater than the value of tangible property in Massachusetts not taxable locally (inventories and manufacturing machinery estimated at $250,000).

Total Corporate Excise:

Income Tax	$ 1,555.07
Corporate Excess Tax	1,660.50
Total Excise Tax	$ 3,215.57

Table III. How the Tax Bite on Industry Varies from State to State *

State	State Tax Revenue per Capita Group (1)	Sales and Use Taxes	Local Tax Revenue per Capita Group (2)	Corp. Income Tax Rates	Allowable Tax Deducti	
					Federal Inc. Tax	Operating Loss Carryover
Alabama	2	3%M**	1	3%	x	
Arkansas	2	3%R,M	1	5%		
Arizona	4	2%R***	2	5%	x	x
California	5	3%	4	4%		
Colorado	3	2%R	4	5%		
Connecticut	3	3%R,M	4	3-3/4%		
Delaware	5	0.7% ****	1	-		
Florida	3	3%R,M	3	-		
Georgia	3	3%R	1	4%		x
Idaho	2	None	3	8%	x	x
Illinois	2	2½%	4	-		
Indiana	1	0.5% ****	3	-		
Iowa	3	2½%R	4	3%	x	x
Kansas	2	2%R	4	2%	x	
Kentucky	1	None	1	7%	x	
Louisiana	5	2%R	1	4%	x	
Maine	2	2%	3	-		
Maryland	3	2%R	3	4½%		
Massachusetts	3	None	4	6.765%		
Michigan	4	3%R	3	-		
Minnesota	3	None	4	6%	x	x
Mississippi	2	3%R	1	6%		
Missouri	1	2% ****	2	2%	x	
Montana	2	None	4	5%	x	x
Nebraska	1	None	5	-		
Nevada	5	2%	3	-		
New Hampshire	1	None	4	-		
New Jersey	1	None	5	-		
New Mexico	5	2%R	1	2%	x	
New York	3	None	5	5½%		
North Carolina	3	3%	1	6%		x
North Dakota	3	2%R,M	4	6%	x	x
Ohio	2	3%R	3	-		
Oklahoma	4	2%R,M	2	4%	x	
Oregon	4	None	3	6%		
Pennsylvania	1	3%R,M	2	6%		
Rhode Island	2	3%R	3	4%		
South Carolina	2	3%R,M	1	5%		x
South Dakota	2	2%R	3	-		
Tennessee	2	3%R	1	3-3/4%		
Texas	2	None	2	-		
Utah	3	2%R	3	4%		
Vermont	3	None	3	5%		

Table III. How the Tax Bite on Industry Varies from State to State*(cont.)

Virginia	1	None	2	5%		
Washington	5	3-1/3%	2	-		
West Virginia	2	2%M	1	-		
Wisconsin	3	None	4	7%	x	x
Wyoming	4	2%R	3	-		

By dividing the total tax collected by the total population in each state, the following groups were evolved and used in columns (1) and (2):

(1) Group 1: 1956 per capita collections $48-$65; Group 2 $65-$80; Group 3 $80-$95; Group 4 $95-110; Group 5 $110-$129.

(2) Group 1: 1955 per capita collections $23-$40; Group 2 $40-$60; Group 3 $60-$80; Group 4 $80-$100; Group 5 $100-$114.

* Information used in this table was obtained from Business Week, July 13, 1957. pp. 112-114

** M - Machinery and equipment exempt.

*** R - Raw materials exempt.

**** No use tax

CHAPTER II

CORPORATE TAXATION IN VARIOUS STATES

New York and Connecticut*

Two of Massachusetts' neighboring states, New York and Connecticut, have taxes similar to Massachusetts in that they reach corporation net income, but different in that they apply capital measures only as minimum alternatives rather than as supplements to the income tax. New York applies a tax at 5.5 per cent of net income allocated to the State according to the three-way "Massachusetts formula", or $1.00 per $1,000.00 of capital allocated to the State.

At 5.5%, the New York tax rate upon net income is the same as the rate applicable in Massachusetts before the additional 23% surtax is determined. It appears, therefore, that a corporation subject to the income tax in New York would pay 81% as much on this basis as would the same corporation in Massachusetts. But the corporation would pay no capital tax in New York as compared with 0.615% upon its corporate excess in Massachusetts.

In the same way, Connecticut taxes corporation net income at 3% and provides a minimum tax at $1.50 per $1,000 of capital and bonded debt. The Connecticut allocation is also according to the "Massachusetts formula" applied to all income except interest and dividends in much the same way as in Massachusetts. The Connecticut income tax differs, however, from the other state income taxes in that interest paid is not allowed as a deduction in determining net income for tax purposes. Since the alterna-

*8, pp. 10-12

tive capital taxes in both New York and Connecticut are below the Massachusetts corporate excess tax rate, a corporation would expect to pay more state taxes than in the two neighboring states in periods when it suffers a net loss as well as in profitable periods.

Computations of what tax our example corporation (Table II) would pay if situated in either New York or Connecticut are found on the following pages.

NEW YORK

Business Corporation Franchise Tax

A. NET INCOME:

Net Income as Shown in Table II		$ 26,000.00
Less-50% Dividends from Non-Subsidiary Corporations		500.00
Entire Net Income		25,500.00
Investment Income:		
50% of Dividends	$ 500.00	
Interest Income	2,000.00	2,500.00
Business Income		23,000.00
Business Allocation (per cent)		86.9
Business Income Taxable		19,987.00
Investment Income	2,500.00	
Investment Allocation (per cent)	.67	
Investment Income Taxable		21,622.00
Tax Rate 5.5%		.055
Income Tax		$ 1,191.00

Allocation Factor:
Three-Factor "Massachusetts" Formula (See "Massachusetts")

B. CAPITAL ALTERNATIVE:

Total Assets as Shown in Table II	$680,000.00
Less-Liabilities with Original Maturities of One Year or Less (Accounts Payable)	80,000.00
Total Capital	600,000.00
Business Allocation (Per cent)	86.9
Taxable Capital	521,400.00
Tax Rate	.001
Total Alternative Tax	$ 521.00

The income tax at $1,191.00 is greater than the alternative tax at $521.00 and therefore it applies. New York provides for special allocation of investment capital, but does not require it unless investment income and investment capital exceed 25% of all income and all capital. This calculation was not made because it would not be required of the example corporation and also it would not prevail as a tax measure in any event.

CONNECTICUT

Corporation Business Tax

A. **NET INCOME:**

Net Income as Shown in Table II	$ 26,000.00
Add-Interest Paid (Not Deductible)	3,000.00
Net Income for Tax Purposes	29,000.00
Less-Interest and Dividends (Not subject to allocation percentage)	3,000.00
Net Income Subject to Allocation	26,000.00
Allocation to Connecticut (Per cent)	86.9
Net Income Allocated to Connecticut	22,594.00
Add-Interest and Dividends	3,000.00
Net Income Taxable	25,594.00
Tax Rate (3%)	.03
Income Tax	$ 769.00

Allocation Factor:

Three-Factor "Massachusetts" Formula (See "Massachusetts")

B. **MINIMUM TAX UPON INVESTED CAPITAL:**

Total Net Worth	$500,000.00
Notes Payable	100,000.00
Total Net Worth and Interest Bearing	600,000.00
Less-Shares of Stock of Private Corporations	75,000.00
Capital and Surplus for Tax Purposes	525,000.00
Allocation to Connecticut (Per cent)	87.6
Taxable Capital and Surplus	459,900.00
Tax Rate (1.5 mills)	.0015
Total Alternative Tax	$ 690.00

Allocation Factor:

All assets except shares of stock in private corporations.

	Tangible	Intangible	Total
Total Everywhere	$400,000.00	$205,000.00	$605,000.00
Total Within Connecticut	350,000.00	180,000.00	530,000.00
Percentage Within Connecticut			87.6

The income tax at $769.00 is greater than the alternative tax at $690.00, and therefore it applies.

New Jersey*

The state which is the most comparable to Massachusetts in size, as well as in industrial characteristics, is New Jersey. In terms of state tax structures, however, they have almost nothing in common. The only direct State tax (exclusive of payroll taxes) paid by manufacturing corporations in New Jersey is the corporation franchise tax which rests upon the net worth of the corporation at 80¢ per $1,000. Net worth is allocated to New Jersey for tax purposes according to the greater of two standards. The first of these is the per cent of all assets situated within the State, with a provision that domestic corporations must apportion at least one-half of their intangibles within the State. The second is the three-way "Massachusetts Formula" with one significant modification relating to the apportionment of sales. The gross receipts part of the formula rests upon an apportionment to New Jersey of one-half of the sales from New Jersey to out-of-state customers, as well as one-half of the sales made to New Jersey customers from out of state. Although the effect of this modification in the apportionment of sales is not the same for all corporations, its most frequent effect is to reduce the percentage of all sales attributed to an industrial state from which sales are made in a national market.

As shown in Table I, the estimated tax for one hypothetical corporation under the New Jersey law totals $356.00 as compared with some $3,215.00 payable by the same corporation under the Massachusetts excise tax. But the fact that the State tax payable in New Jersey amounts to

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only a little more than one-tenth as much as that which would be payable in Massachusetts shows that the comparison cannot be completed until the local taxes are included. New Jersey is a local property tax State, and the major tax paid by manufacturing corporations in the State is that assessed locally upon their real estate as well as upon their tangible personal property.

NEW JERSEY

Corporation Franchise Tax

Net Worth as Shown in Table II	$500,000.00
Allocation (See Below)	89%
Taxable Net Worth	445,000.00
Tax Rate (8/10 mill per $1.00)	.0008
Total Corporation Franchise Tax	$ 356.00

Allocation Factors:

(1) Business Factors:

	Total	New Jersey	Per Cent
Tangible Property	$400,000.00	$350,000.00	87.5
Payrolls	300,000.00	270,000.00	90.0
Gross Receipts (Sales)*	600,000.00	400,000.00	66.6
Average Percentage			81.4

(2) Asset Factors:

	Total	New Jersey	Per Cent
Tangible Property	$400,000.00	$350,000.00	
Cash and Securities**	125,000.00	125,000.00	
Receivables and Other Assets	155,000.00	130,000.00	
Totals	$680,000.00	$605,000.00	88.9

Since (2) is the larger allocation, it is used in the computations.

* Sales attributed to New Jersey represent all sales made from an office within the State to a destination within the State, plus one-half of all sales within the State to an out-of-state destination.

** Assuming that all corporate stocks and all deposits have situs within the State.

Michigan*

Another important industrial State which is in direct competition with Massachusetts is Michigan. While Michigan does not assess a corporation income tax, it applies a corporation business license fee which is, in effect, a tax at $2.50 per $1,000 upon contributed capital and retained earnings. Thus, the Michigan tax amounts to 25/100 of 1 per cent upon invested capital as compared to 65/100 of 1 per cent rate at which the corporate excess tax applies in Massachusetts. The capital measure, and more especially the interstate apportionment based upon the percentage of the corporation's property within the State is not necessarily the same in Michigan and Massachusetts. But the general result is that the Michigan tax can never be as high as the Massachusetts tax, even in periods when the manufacturing corporation reports a net loss and is thus not liable for the Massachusetts income tax.

From the standpoint of large corporations, there is another feature of the Michigan tax which sets it apart as a tax favorable to corporations. Because the corporations business license fee in Michigan applies a ceiling of $50,000, it can never result in taxes amounting to large burdens upon the big corporations. For example, a corporation taxable in Massachusetts upon $740,000 of net income would pay $50,000 of income tax alone. In addition, it would pay the corporate excess tax at rates about two and one-half times those applicable to contributed capital and retained earnings in Michigan. While the amount of tax liab-

*8, pp 14-16

ility above this level in Massachusetts would rise as the earnings and invested capital increased, the Michigan tax would never exceed $50,000.

Michigan, like North Carolina, applies a State tax upon intangible personal property measured as 3 per cent of the income from the intangibles, or 1/10 of 1 per cent of their value, the Michigan intangibles tax was the source of some $11,000,000 of State revenue in 1950. The one exception in the general rate structure is that money and deposits are taxed at 1/25 of 1 per cent. In the case of most manufacturing corporations, the intangibles tax in Michigan is not a major tax burden. A provision that accounts payable may be deducted from accounts receivable has the effect of eliminating this class of intangible assets from the tax base for many manufacturing corporations. This leaves corporate stocks and bonds and cash and deposits as the principal intangible properties subject to the tax. But cash and deposits with situs in the State are taxed at a low rate (1/25 of 1 per cent), and manufacturing corporations do not as a rule hold large amounts of cash or corporate securities in relation to their total assets.

MICHIGAN

Corporation Business License

Total Net Worth (Capital Stock and Surplus)	$500,000.00
Allocation to Michigan	.89
Taxable Capital and Surplus	445,000.00
Tax Rate (2.5 mills per $1.00)	.0025
Total Corporation Business License Fee	$ 1,112.50

Allocation Factors:

	Total	Michigan
Tangible Property	$400,000.00	$350,000.00
Cash*	50,000.00	50,000.00
Corporate Stocks Held*	75,000.00	75,000.00
Receivables	150,000.00	125,000.00
Other Assets	5,000.00	5,000.00
	$680,000.00	$605,000.00

Per cent within Michigan 89%

Intangibles Tax

Accounts Receivable - Accounts Payable		-
Corporate Stock		$75,000.00
Tax Rate (1/10 of 1%)		.001
Tax on Corporation Stock		$ 75.00
Less-Statutory Exemption		20.00
Net Tax Payable on Corporate Stock		$ 55.00
Cash and Deposits	$50,000.00	
Tax Rate (1/25 of 1%)	.0004	
Tax on Cash and Deposits		20.00
Total Tax upon Intangibles		$ 75.00

* Assuming that all corporate stocks and all deposits have situs within the State.

Indiana*

A different type of tax applicable to an industrial state is the gross income tax applied in Indiana. Manufacturing corporations pay 1/2 of 1 per cent upon their gross receipts from sales made to Indiana customers. The basic rate of 1/2 of 1 per cent upon manufacturing sales is a high rate tax upon gross business done. For example, in the case of a manufacturing corporation which earns 8% on its sales, the Indiana gross income tax rate is the equivalent of a 6.25 per cent income tax. However, it is softened considerably in the case of interstate business by the provision that only those sales made from Indiana offices to Indiana customers are regarded as intrastate sales and thus taxable. Sales made by manufacturing concerns within Indiana to destinations outside the State are not subject to the gross income tax. The result is that Indiana is a favorable tax location for manufacturing corporations selling in a national market.** Therefore, if a company's entire production were to be sold outside the State of Indiana, its State taxes might be the nominal report fee of $2.00, plus a small property tax. However, the other states in which the sales were made might levy various taxes on business done with the amount depending upon the State and on the form of the transaction.

Like Michigan and North Carolina, Indiana applies a State intangibles tax. It rests upon the value of securities and other evidences of debt at five cents per $20.00. This tax does not extend to accounts receivable or other intangible values of a nature which do not lend them-

* 8, pp. 18-20

**10, p. 138

selves to a stamp tax. Also specifically exempt under the tax are stocks of Indiana corporations and deposits in Indiana banks. Thus, it is mortgages, notes, bonds, foreign corporation stocks, and such related properties that become subject to the tax.# In this way the intangibles tax in Indiana rests upon a modest tax burden for the usual business or corporation.

In 1957, Indiana increased the tax rate on income from wholesale sales (excludes wholesale grocers) from 0.25% to 0.375%. Reduced income tax rate on retail merchants, dry cleaners and laundries from 0.5% to 0.375%.

INDIANA

Gross Income Tax

Sales from Home Office within the State		$300,000.00
Tax Rate for Manufacturers		.005
Total Tax upon Sales		$ 1,500.00
Income from Interest and Dividends	$3,000.00	
Tax Rate for "Other Income"	.0125	
Total Tax upon Other Income		37.50
Total Gross Income Tax		$ 1,537.50

The above computation is based upon assumption that all sales are taxable at the rate for manufacturers. As a matter of experience in Indiana, some sales by manufacturers are made in ways which cause them to be taxed as retail sales (0.375%).

Intangibles Tax

Book Value of Stock in Foreign Corporations	$25,000.00
Tax Rate (5¢ per $20.00)	.0025
Total Intangibles Tax	$ 62.50

Book value is not always acceptable as "full value for tax purposes, but is used here for purposes of illustration. All corporate stocks held are assumed to be administered from Indiana and thus to have situs there. Capital stock of domestic corporations and bank deposits are exempt from the tax, and accounts receivable are apparently subject to the tax when they are evidenced by a security which can be stamped.

North Carolina and Pennsylvania*

Among the states under comparison North Carolina and Pennsylvania have corporation taxes most comparable to those in Massachusetts. Like Massachusetts, these states apply both net income taxes and capital taxes. The North Carolina tax consists of a corporation net income tax at 6% per $1,000 of capital and retained earnings allocated to the State. Pennsylvania supplements a 6% corporation net income tax with a franchise tax (for foreign corporations) or a capital stock tax (domestic corporations), at $5.00 per $1,000 upon the value of capital stock apportioned to the State. In each instance these state taxes in North Carolina and Pennsylvania are comparable to Massachusetts in measure but lower in rate.

Interstate allocation factors provided under the corporation income tax measures in Massachusetts and Pennsylvania are comparable. Both apply the three-way "Massachusetts Formula" to which the Commonwealth has given its name. In various forms, the general outline of this formula has received wide acceptance among the states as an allocation of business income and capital according to (1) payrolls, (2) gross receipts, and (3) property. North Carolina departs from the pattern in that it provides a two-way allocation for manufacturing corporations resting upon (1) property, and (2) cost of manufacturing. However, difficulties generally encountered in determining the costs of manufacturing are met with the provision that the Commissioner of Revenue may grant permission to substitute payrolls for this factor. The net result is that North Carolina allocation may be

*8, pp. 22-24

reduced to a formula resting upon two of the three "Massachusetts" factors.

On the capital side, North Carolina applies a definite allocation formula to the capital of domestic corporations doing an interstate business. Whereas the two-factor formula based upon (1) property, and (2) cost of manufacturing applies only to the determination of the minimum tax base under the income tax, the same formula applies to the allocation of capital under the corporation franchise tax. Massachusetts does not apply an allocation formula to the capital of domestic corporations, but permits deductions from capital on account of the value of property taxed locally and property outside the State. It should also be noted that North Carolina, unlike Massachusetts and Pennsylvania, supplements its income and capital taxes with a State assessed tax upon intangible property.

NORTH CAROLINA

Corporation Income Tax

Net Income from Table II	$26,000.00
Plus State Income and Franchise Taxes Paid and Deducted for Purposes of Federal Tax	2,000.00
Income Subject to Allocation	28,000.00
Allocation to North Carolina	88.75% to 100%
Income Allocated to North Carolina	24,850.00 to $28,000
Tax Rate (6%)	.06
Total Income Tax	1,491.00 to $1,560 assumed at $1,500

Allocation Factors:

The entire net income of domestic corporations is taxable unless a portion is taxed in another state.

Domestic corporations may deduct net income from business or property in another state only if the net income is taxable in the state where the business or property is located. Domestic corporations having business or property in another state which does not levy an income tax are required to treat income derived from such business or property as though it occurred within North Carolina.

However, the amount of net income taxable in North Carolina shall not be less than would be allocated within the state by a two-factor formula based upon property and manufacturing costs:

	Total	North Carolina	Per cent
Tangible Property	$400,000.00	$350,000.00	87.5%
Payrolls*	300,000.00	370,000.00	90.0
Average Percentage			88.75%

*Payrolls used in lieu of manufacturing costs

NORTH CAROLINA (continued)

Corporation Franchise Tax

Contributed Capital and Retained Earnings from Table II	$500,000.00
Allocation to North Carolina (per cent)	88.7
(1) Capital Allocated to North Carolina	443,500.00
(2) Investment in Tangible Properties within North Carolina, less Indebtedness	350,000.00
(3) Assessed Value of all Properties in North Carolina including Intangibles	Not Estimated
Tax Base, larger of the three above	443,500.00
Tax Rate ($1.50 per $1,000)	.0015
Amount of Tax	$ 665.00

Allocation Factors:

Apportionment of capital for manufacturing corporations according to (1) tangible property and (2) cost of manufacturing (see corporation income tax (above) for calculation).

Intangibles Tax

	Tax Base	Tax Rate	Amount of Tax
Money on Deposit	$50,000.00	.001	$50.00
Accounts Receivable	125,000.00		
Less 83% of Accounts Payable	66,400.00		
Accounts Receivable Taxable	58,600.00	.0025	146.00
Shares of Stock in Foreign Corporations	25,000.00	.0025	62.00
Total Intangibles Tax			$258.00

Calculation of the intangibles tax involves assumptions about value and business situs not only for the taxpaying corporation but also for the corporations in which the taxpayer holds stock.

For example, corporate stock is taxable in the same ratio as the business and holdings of the issuing corporation outside North Carolina relates to the entire business and holdings of the corporation, so that stock of corporations situated entirely within the state is exempt. The Department of Revenue provides lists of such percentages for use by intangibles taxpayers. For purposes of illustration, it was assumed that stock held by the example corporation in other domestic corporations ($50,000) represented companies entirely within the State and therefore exempt, while the holdings in foreign corporations (25,000) represented companies entirely outside the State and therefore taxable in full amount - stocks are presumably valued according to their market as of December 31.

Money on deposit is taxable on the basis of the average quarterly balance - but the single balance sheet total was used in the comparison because the quarterly data were not available.

Accounts payable are deductible from accounts receivable in the same proportion as the taxpayers accounts receivable have a taxable situs within North Carolina - thus the assumption that $125,000 of the $150,000 of accounts receivable shown for the example corporation have a taxable situs in the State means that 83 per cent of the current accounts payable may be deducted.

PENNSYLVANIA

Corporation Income Tax

Net Income as Shown in Table II		$26,000.00
Less-Corporate Dividends		1,000.00
Income Subject to Allocation		25,000.00
Allocation to Pennsylvania (per cent)		86.9
		21,725.00
Tax Rate (6%)		.06
Total Income Tax		$ 1,303.50

Allocation Factor:

Three-factor "Massachusetts" formula (See Massachusetts)

Capital Stock Tax

Total Assets per Table II		$680,000.00
Less-Exempt Assets:		
Stock of Pennsylvania Corporations	$50,000.00	
Tangible Property Outside Pennsylvania	50,000.00	100,000.00
Assets Taxable in Pennsylvania		580,000.00
Per Cent of Assets Taxable in Pennsylvania (%)		.85
Value of Capital Stock (Assumed as Net Worth)		500,000.00
Proportion Taxable as Computed Above		.85
Taxable Value of Capital Stock		425,000.00
Tax Rate ($5.00 per $1,000)		.005
Capital Stock Tax		$ 2,125.00

This capital stock tax applies to domestic corporations. The value of capital stock may be market values, net worth or capitalized earnings. Foreign corporations pay a franchise tax upon a similiarly determined capital value allocated to Pennsylvania according to the three-way "Massachusetts" formula.

South Carolina*

South Carolina bases its State tax on net income alone. It consists of a computation of five per cent (5%) of net income, provided that the tax so computed is not less than would be produced by applying a rate of 3 per cent to a base consisting of the net income plus salaries and other compensation paid to all officers and any stockholders owning in excess of 5 per cent of the issued capital stock of the corporation, after deducting from the base $6,000.00 and any deficit reported for the year.

South Carolina does permit domestic corporations to exclude that part of their income which is taxed in other states. For foreign corporations an allocation formula is provided not unlike those of other states. It provides that a proportion of its entire net income be computed on the basis of the arithmetical average of the following two ratios: (a) the ratio of the value of the real estate and tangible personal property in this State to the value of all real estate and personal property, with no deduction for encumbrances thereon, and (b) the ratio of the total cost of manufacturing to the total cost of manufacturing within and without the State during such income year. No tax on capital is provided for foreign or domestic corporations.

*12, Section 8

SOUTH CAROLINA

Corporation Income Tax

(1)

Net Income as Shown in Table II	$26,000.00
Less-Dividends and Interest Received	3,000.00
Income Subject to Allocation	23,000.00
Per Cent Allocated to South Carolina	86.9
	19,987.00
Add-Back Interest and Dividends	3,000.00
Net Income for State Purposes	22,987.00
Add-Compensation of Officers (assumed)	30,000.00
	52,987.00
Deduct Statutory Exemption	6,000.00
Net Taxable Income	46,987.00
Tax Rate at 3%	.03
South Carolina Tax	$ 1,409.61

(2)

Net Income (see above) for South Carolina Purposes	$22,987.00
Tax at 5%	.05
Net Income Tax	$ 1,149.35

The greater of the two is (1) $1,410.00 and constitutes the tax that applies.

ALASKA

(1) Business License Return

Net Sales	$600,000.00
Tax - Gross Receipts over $100,000 ($400 plus 1/4% over $100,000)	1,650.00

(2) Corporation Income Tax

Net Income for State Purposes (See South Carolina)	$22,987.00
Less-Dividend Credit	850.00
Balance	22,137.00
	X 52%
	11,511.00
Less	5,500.00
Federal Tax Liability on Income from Alaskan Sources	6,011.00
Alaska Income Tax - 18% of the Federal Liability	$ 1,082.00
Total Alaska Tax	$ 2,732.00

Alaska*

Since Alaska has become the forty-ninth State and is depicted as growing in industrial stature, a resume and comparison of its corporate tax structure seems in order.

All businesses whether corporate or other forms must file a Business License Return and in addition, corporations must file a State income tax return. The Alaska Business License return provides a tax on the net sales of all businesses. The net sales are computed by deducting from gross sales (1) refunds or allowances on returned goods, (2) cash discounts allowed and taken on sales, (3) uncollectible accounts written off and previously reported as gross receipts under this Act as well as other deductions peculiar to various business such as contractors or car dealers (where trade-ins are a deductible item from gross receipts). The State tax rates for net sales are $25.00 for gross receipts under $20,000.00, 1/2% of all gross receipts in excess of $20,000.00, and $400.00 plus 1/4% over $100,000.00.

The Corporation Income Tax Return is identical in form and content with that of the Federal Corporation Tax Return (#1120) except that a reconciliation of income and surplus (Federal Schedule M) is not provided. Since the return is identical to the Federal, a tax on income only is provided. After arriving at the Federal Income Tax liability, the Alaska Income Tax is computed at 18% of the Federal liability. Of course, operating loss carry-overs and carry-backs are allowable, the dividend deduction of 85% and all other deductions peculiar to the Federal Tax

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Alaska (continued)

Return #1120 are incorporated in the Alaskan Tax Return.

California*

The California tax in common with most States does not have a tax computed on corporate excess. The corporate liability lies purely on income alone. The bank and corporation Franchise Tax Return of California is similar to the Massachusetts computation of income and allocation of this income is made according to the "Massachusetts Formula". No operating loss carry-over or carry-back is allowed but a charitable contribution carry-over is allowed. The tax rate, however, differs from Massachusetts in that the corporate net income is taxed at only 4%.

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CALIFORNIA

Bank and Corporation Franchise Tax Return

Net Income from Table II	$26,000.00
Less-Interest and Dividends	3,000.00
Income Subject to Allocation	23,000.00
Allocation Percentage (see below)	86.9
	19,987.00
Add-Back Interest and Dividends	3,000.00
Net Income for State Purposes	22,987.00
Tax Rate	.04
Total California Tax	$ 919.48

Allocation Schedule:

	Total Everywhere	California Total	Per Cent
Tangible Property	$400,000.00	$350,000.00	87.5
Wages and Salaries	300,000.00	270,000.00	90.0
Sales	600,000.00	500,000.00	83.3
			260.8%
1/3 of Total			86.9%

Florida* and Illinois**

Both Florida and Illinois have no State income tax on business enterprises. At first glance one would consider this a perfect setting for a corporation which usually found State income taxes burdensome and excessive. However, in lieu of State income taxes, each State has evolved a tax to compensate for the lack of corporate income taxes.

To begin with, Florida in addition to city real estate and property taxes levies a county real estate and property tax which conceivably, if considered in the comparisons, could eliminate most of the savings that are first apparent. Nevertheless, the point has been made that Florida does not tax incomes of corporations. For business or manufacturing corporations the State imposes a capital stock tax based on the invested capital represented by shares of stock outstanding. It does not exceed $1,000.00 and for a corporation such as the example we are using the tax on the capital stock figure of $300,000.00 is $200.00.

On the other hand, Illinois has a franchise tax based on capital stock which for our example corporation amounts to $20.00. However, Illinois currently has a sales tax as well as a use tax. To explain, all sales made intrastate to consumers must charge a sales tax and certain Illinois cities have a municipal tax (Chicago, Skokie) which also must be added to the sales price and eventually paid to the State by the seller. All purchases by consumers ordered from out of state sellers must have a

* 13 P. Chapter 608, Section 33

**11, pp. 131-134

use tax added to the purchase price and the out of state seller must pay this tax to Illinois on all sales made to Illinois purchasers. If the goods are being purchased for resale the use tax does not apply. It may be well to point out that all types of business enterprises (i.e. proprietorships, partnerships, and corporations) are subject to the sales and use tax. Reference to Table III shows the States and the rates which are currently levying sales and use taxes.

It should be noted that the level of business activity in the States affects our comparison. The general business cycle as well as fluctuations in the activity for each individual business are important factors in projecting a comparative tax study. The time at which comparisons are made may well influence the comparative tax picture. For example, a comparison based upon high corporation earnings would be expected to yield different results as between an income tax State such as Massachusetts and a property tax state such as New Jersey, than would a similar comparison based upon a lower level of corporate earnings or even upon a corporate net loss. Comparisons made at a time when accumulated earnings have been used to expand net worth or invested capital would be expected to yield different results as between a State like Massachusetts, where the corporate excess rests upon such a measure, and a State such as Indiana, where invested capital plays almost no part in the State's tax base.

CHAPTER III

Property Taxes and Local Considerations

Comparison of State taxes on corporations alone is not enough. Local taxes with the resultant disparity in assessed values must be considered.

Throughout the second chapter in our explanation of the various States' basis for taxes we have made frequent references to property taxes. Assessment procedures, political favoritism and the attitude of people toward industry are important elements of this subject.

At one time property tax was characterized by its general and universal applications, but classification and exemptions have removed much property from the list of ratables.* Some local governments, for example, classify property by applying preferential rates to new industry, others use special rates on mining properties. Exemptions are also increasing, with some States removing personal property from the tax roles and granting homestead and veteran's exemptions.

The assessment process itself contributes a restraint on the valuation of property for tax purposes. Once placed on the tax roles, the assessed value becomes unresponsive to rising market values. The postwar appreciation in values has been viewed by many as temporary, and local assessors, often being elected officials, have refrained from increasing assessments. Increases in assessment which have been recorded seldom keep pace with increases in value.

Again, we must consider the human element. An article by the

*2, pp. 10-11

Fantus Factory Locating Service expresses this factor very well by saying that manufacturers are becoming more and more conscious of how the costs of doing business differ around the country.* Much of the variation, they find, stems from the great disparity in State and local government taxes. While a company expanding into another area will probably first scan the labor, raw materials markets, and power potentials, the company - all things being equal - is apt to settle for the community where taxes are the lowest. The taxes to be considered are:

State Income and Franchise Tax

Local taxes on property, both real and personal (machinery, equipment, and inventories)

State taxed for unemployment and workmen's compensation

The figures were compiled by the Fantus Factory Locating Service of New York for testimony at a hearing of New York Joint Legislature Committee, on the State's economy.# The Committee has a broad mandate to determine what the State might do to help retain industry and attract new payrolls. Leonard C. Yaseen, Fantus senior partner, uses these figures to demonstrate to the Committee how New York compares with other States.

The problem with most previous studies below the Federal level has been that they do not cover all these factors. Some compare only State income and franchise taxes. Others take on local taxes, too. But most ignore workmen's and unemployment conpensation taxes.

A comparison of per capita collections gives us a broader picture.# It shows which States are high, which are low. It also shows that

*5, pp. 112-114
See Table III on pp. 23 and 24

largely because States differ in how they divide services and funds with cities, New Jersey can have the lowest per capita collection of State taxes, but be second only to New York in local taxes. Conversely, Louisiana is near the top in State collection, but near the bottom in local per capita revenue. And by adding per capita state and local figures, California comes out on top, with New York in second place.

Per capita figures, of course aren't the whole answer to a manufacturer's question. He is even more concerned - aside from quality of governmental services - with whether taxes are slapped disproportionately on business or whether they are more broadly based. Sampling at the New York hearing, Mr. Yaseen cited a study by the Pennsylvania Economy League of the tax burden that falls on a hypothetical corporation (13.9 million sales) in each of ten industrial States. Using a median city in each State, the League found: in State taxes, the mythical company would pay $177,000 in Pennsylvania, but only $1,570.00 in Delaware. New York ranked third with $110,000. When local taxes were included, Flint, Michigan paid highest, while Syracuse, New York dropped to seventh.

But the addition of Workmen's Compensation taxes changes the picture. It puts Syracuse with a tax bill of $376,994.00 in second place behind Flint ($406,674).

Unemployment and Workmen's Compensation taxes are particularly important with manufacturers having big work forces, since these taxes are geared to payrolls, and vary with job stability and hazards. Also, a State oriented to labor is likely to have higher benefits, and these are bound to show in higher taxes.

Again, there is an incredible variety in the rates and the basis of assessment of real property. More flexible in its administration is the taxation of personal property, but for many companies it is the more costly tax.

Among corporate tax authorities there is agreement on the value of personal acquaintance with local assessors. "We make a practice," says one, "Of going around the country and cultivating assessors."

In the main, the last five or six years have been a period of wide-scale revision in local assessment practices. Valuations which would have tended to remain unchanged over a period of years are coming in for close scrutiny as it becomes apparent the pre-war price levels are not likely to return and as the cities feel the pressure for added tax ratables. In some cities the upward revisions of assessments has already taken place, while in other cities it is only contemplated. The result is that some variation in the comparative tax estimated will arise as between cities which have revalued and those which have not as yet done so. From the standpoint of preparing tax estimates there is always the contingency that the assessors may prepare their estimated valuations in terms of the newer and higher standards which are in the process of being put into effect, but which have not as yet been applied to the older properties within their jurisdictions.

Although the amount of local property tax which the corporations would be assessed in each State can be estimated with acceptable accuracy, the amount and quality of services provided by local government cannot. Such things as adequate police protection, the condition of the streets - paved or unpaved - whether or not water is available at reasonable service rates, ought to be considered in relation to local taxes because when the local government does not provide them the corporations may be forced to themselves. In the matter of fire protection a high calibre local fire department in addition to providing protection to corporate property may have its excellence reflected in low-rate fire insurance. While these and other related items are important in determining the cost of doing business in the several locations, there is no accurate way of calculating their value in dollars and cents. Because of this, the study has assumed that the services provided by the local government to the corporations were equal in each instance.

In September, 1958, the General Electric's public relations department asserted, "The Staté's property tax (Massachusetts) is considered to be the most burdensome of any American State and the fastest growing of all major Massachusetts taxes.* It went up 33% in three years and 10 per cent, or $54,000,000 in the past year, of which home owners and tenants will contribute $34,000,000 with business paying the rest.

*7

CHAPTER IV

Recent Developments in State and Local Taxes

Since Massachusetts has one of the highest State business taxes in the nation, the local governments have compensated somehwat for the burden that faces a new or existing corporation. Cities and towns with an eye to the encouragement of new industry have granted either low assessments or no property taxes in the first year of the corporation's existence. In fact, Boston has initialed a momentous step forward in the property tax field by gearing its property taxes to the gross revenues received by corporations building new real estate in the city area. This is sure to expand into the other industrial areas of the Commonwealth as well as to encourage a more broadening attitude on the part of assessment authorities.

Several states in 1955 ordered commissions to study their tax structures to seek new sources of revenue and to remove inequities from the tax laws.

Minnesota*

A Minnesota commission, for example, proposes that property taxes be cut, including levies on manufactruers' inventories. It hopes in the long run that the losses on revenue would be made up through higher yields from sales and income taxes.

North Carolina*

A North Carolina commission called for rewriting the tax laws that block further industrialization and discriminate against some present

*6, pp. 75-77

business taxpayers. It recommends lowering the tax take by $8.8 million - of which $6.5 million would come in corporate income taxes in the hope that new industry attracted by the new rates would more than make up the difference.

Arkansas*

In Arkansas, a uniform basis of assessment for all counties has been proposed so that from a tax standpoint - each county would have an equal crack at new plants.

In their eternal quest for revenues, more States seem to be running afoul of constitutional prohibitions as to what they can tax and what they can't tax. Here are several relatively recent State tax developments that may be of interest to corporations operating in those States.

Pennsylvania - Corporation Income Tax*

Pennsylvania enacted a corporation income tax in 1951 which was intended to apply principally to foreign corporations which own property or carry on activities within Pennsylvania but which are not subject to the corporate net income tax or the franchise tax because they do not qualify under the prevailing judicial concepts and requirements as to "doing business" within the Commonwealth of Pennsylvania. The tax was denominated by statute as a property tax on the net income derived by certain corporations from sources within the Commonwealth. However, the tax has since been held to be a "privilege" tax based on such net income. (Commonwealth v. Eastman Kodak Company 385 Pa. 607 (1956).

*6, pp. 75-77

This tax has received a rough reception by the counts in two decisions testing its constitutionality under the following facts:

1. In Roy Stone Transfer Corporation v. Messner 377 Pa. 234 (1954) the act was held unconstitutional as to its application to a purely interstate motor carrier.
2. In Eastman Kodak, the act was held unconstitutional as to its application to a foreign manufacturer which has no office or place of business in Pennsylvania, and has no property except several salesmen's automobiles in Pennsylvania, and makes no contracts and accepts no orders in Pennsylvania. Therefore, it would behoove those taxpayers filing under this act to reconsider their situation in light of the above decisions, since the courts seem to be greatly limiting the act's application.

Massachusetts*

Under the existing law governing the Massachusetts Corporation Excise, all corporate gross receipts are classified as Massachusetts gross receipts "except those negotiated or effected in behalf of the corporation by agents or agencies situated at, connected with, or sent out from premises for the transaction of business owned or rented by the corporation outside the Commonwealth." This applies to Massachusetts business and manufacturing corporations and also to foreign business and manufacturing corporations doing business in Massachusetts. Massachusetts gross receipts

*6, pp. 75-77

are important in computing the corporation excise because they are the basis of one of the minima (1/20 of 1 per cent of Massachusetts gross receipts plus 3 per cent of net income plus 23 per cent surtax) and also a factor in allocating income in and out of the State.

In a decision published on 12/7/56 (Breck v. State Tax Commission), the Massachusetts Appellate Tax Board held contrary to the statute that the following were interstate receipts and not Massachusetts gross receipts:

"(b) Sales by salesmen resident in Massachusetts to out-of-state dealers and customers, delivery being made outside Massachusetts from stock in Massachusetts.

(c) Sales by salesmen resident outside Massachusetts to out-of-state dealers and customers, delivery being made outside of Massachusetts from stock in Massachusetts."

It is understood that the case is not being followed by the State Tax Commission and is being appealed to the Massachusetts Supreme Judicial Court. In 1957 the Supreme Court ruled against the Appellate Tax Board.

Massachusetts - New Valuations Procedures for Corporate Excess

1. If the corporation excess portion of the tax falls on net worth, then the net worth may be reduced by whichever of the following is the lesser: (a) 20 per cent of net worth, or (b) 25 per cent of fixed assets not taxable locally, but in no event may the net worth be

reduced below the value arrived at by the earnings formula (2 times net worth plus 10 times average earnings divided by 3). Obviously this exception applies when the capitalized earnings are less than the net worth.

2. If the stock of a corporation is listed on a stock exchange or actively traded, then it is mandatory that the following formula involving market value be used: 3 times net worth plus 2 times average earnings capitalized at 10 per cent plus market value on balance sheet date, all divided by 6.

The recent changes in Federal tax laws regarding small corporations and the resultant distribution of profit has not as yet been considered by the State Tax Commission. The current State practice is to treat such distributions as dividends rather than as compensation. Rather than to dwell on the differences between State and Federal tax returns it might be well to state here my complete belief in the idea that Massachusetts should consider operating loss carry-backs and carry-forwards and ally itself with the changes made in the Federal tax laws. I say this not only because the preparation of returns would be less complicated but because of the very reasons these laws were passed in the first place.

Since the State willingly shares in corporate income, they should also share in the losses. Differences in Federal and State returns cause numerous difficulties in reporting and for the sake of simplification and standardization State and Federal returns should coincide.

Limitations of this Study

The tax estimates upon which this study is based were calculated with great care. But despite this, the variations possible in local property tax assessment might easily alter the amount of the total tax impact to such an extent that the results shown in the study would be materially different from the total State and local property tax which would actually be levied. Even the most precise local assessment methods leave much to the judgment of the assessor. The assessment which would prevail in any jurisdiction can never be estimated exactly from even the best property descriptions. In the final analysis, there is considerable amount of negotiation between taxpayer and assessor, and the level of property assessment which finally prevails grows out of compromises which involve almost unlimited combinations of value judgments. Under these circumstances inter-jurisdictional comparisons can never be made with precision.

CHAPTER V

Conclusions

In February, 1952, a State Tax Commission was appointed by the Legislature to report on Massachusetts Excise Taxes and because of its value and pertinence to our subject matter, the following observations were made by the Commission.

In general, they found the tax unduly complicated in structure and inequitable in its operation.* In particular, they felt that the scope of the Excise Tax was adequately broad as applied to business and manufacturing corporations and that interstate commerce should be made to pay its way through non-discriminatory taxation so far as this is constitutionally possible. Furthermore, the income measure of the corporation Excise Tax is well designed, although the rate is probably the highest of any State in the nation. The present conglomeration of permanent, temporary, and surtax rates on new income should be consolidated into a single rate.

Conditions of corporate life and the complexities of corporate enterprises have changed so radically since the introduction of taxing corporate excess that this theory is no longer acceptable for purposes of corporate franchise taxation. The multiple method of valuing capital stock has produced inequitable results. A simplification of the tax and methods of determining tax liabilities is badly needed. Also needed is a reduction in the requirements of the law for the exercise of administrative discretion in view of the prime importance of certainty and

*9, pp. 55-59

equality of treatment among all taxpayers.

In the Introduction of this study, I called attention to the unfairness of the corporate excess portion of the Excise Tax. This was not an original contention for the Commission also proposes the outright repeal of the corporate excess measure. It should be replaced by an alternative minimum tax of $2.50 per $1,000.00 (without surtax) on corporate net assets without any of the present deductions. This supplement would not be an additional tax, as is the present corporate excess, but an alternative minimum. The base should include only net assets employed within the State. This proposal will eliminate the necessity of the present alternative minimum tax of 1/20 of 1 per cent of the capital stock value. As a substitute for the corporate excess tax, it was proposed that a State-assessed locally collected "in lieu" tax of $6.00 per $1,000 be levied on all tangibles situated in the Commonwealth and not subject to local taxation.

The Commission's Conclusions

The Commission's conclusion in their report is that the overall burden of State and local taxes tends to be higher than that imposed by the majority of the competing States studied. They gave some support to the attitude which apparently prevails outside of Massachusetts that this is a "high tax State". Whatever may be the importance of Massachusetts corporate taxes in relation to the total cost of doing business, the attitude seems to exist that companies which are expanding or considering a net location, may never bother to penetrate the facade of a high State corporate tax rate.

The Commission, therefore, recommended a rate reduction in the income measure from the present rate of 6.765% to a flat 6%.

Corporate Excise Tax liability will thus be 6% of net income or $2.50 per $1,000 of net assets employed in the Commonwealth, whichever is the greater. For the purpose of simplicity of the return and a reduction in the necessity of administrative discretion, net assets should be defined wherever possible, in accordance with the values used by the corporation for Federal income tax purposes. The alternative minimum tax on net assets coupled with the in lieu tangibles tax will afford additional stability to the yield of taxes on corporate business which in periods of high level business activity will continue to depend heavily on income.

The in lieu tax on Massachusetts tangibles not locally taxable should be divorced from the determination of the corporation franchise tax. The exemption of machinery from local taxation now afforded to manufacturing corporations should be extended to business corporations. It is not possible, due to the absence of adequate public records to estimate the amount involved in this item, but it is not believed to be large.

With no local tax on the machinery or merchandise of either business or manufacturing corporations there should be imposed a State assessed, locally collected tax on all Massachusetts' tangibles not locally taxable including the value of inventories of raw materials, work-in-process, semi-finished goods and finished goods. Such a base would be smaller than that now used for corporate excess. It corresponds to the base now used in the tangibles minimum. Values again wherever possible should be those used for Federal income tax purposes. In this report the Commission has made plain its belief that corporation tax rates are too high. It wishes to make equally plain its belief that even with the rate adjustments suggested the tax will be heavier than it ought to be if Massachusetts business is to have a favorable competitive position among the States. Taking into account all of the proposed changes, Massachusetts, for example, will still tax corporations at higher rates on income and capital than New York which also exempts all personal property from local or in lieu taxes.

The Commission had proceeded from the outset upon the basis that Massachusetts should levy an equitable and substantial corporation tax and that it should be considered as an important and relatively stable part of a sound revenue system not subject to radical fluctuation from year to year. Too often in the past the corporate tax has been used to provide money for extra-ordinary purposes. Rate increases first authorized as temporary additions have remained permanently in the tax structure long after the original need has disappeared. Extraordinary needs are better met by extraordinary levies. The fundamental revenue structure is weakened and distorted when major and continuing sources alreadydedicated to important public purposes have temporary taxes and surtaxes pyramided upon them because of legislative unwillingness to come to grips with long-term necessities.

Our goal must be a corporation tax at a reasonable rate, computed upon a formula understandable to the taxpayer, containing elements of stability sufficient to give both business and the Commonwealth some assurance for the future.

While the industrial tax climate of Massachusetts has not been good, some very favorable imposing factors have to some extent balanced the unfavorable ones. With excellent technical and engineering schools in the area many business leaders have realized the fine opportunity to acquire skilled workers that exist in Massachusetts and New England. The electronics industry has taken over our economy where the textile industry left off and fortunately has brought better working conditions, higher pay and tremendous potential to the New England, and specifically the Massachusetts areas.

The comparisons and suggested changes mentioned in this study should be very strongly considered if we are to encourage the growth of industry in Massachusetts. Our selection of industrial states was made to fortify the contention that Massachusetts is a "high tax State". Industrial leaders have agreed that the sales tax proposals are brightening the hopes of bolstering our industrial economy. If additional State revenues are needed, the sales tax or increases in personal income tax should be at least two of the possible methods considered and not, as the State seems currently aware of, in higher corporate taxes.

It is hoped that the ideas and current practices brought out in this study emphasize the need for reconsideration of our corporate excise tax structure. It seems obvious that associating the State business corporation tax to values and laws established by the Fedsral tax authorities is a sensible and practical way to more simplification and less confusion in our State taxes. It is apparent that changes should be made, and the methods used in other States and stated in the foregoing comparisons should receive prime consideration in the search for more equitable and comparable corporation taxes in Massachusetts.

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