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REPORT
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COMMISSION ON TAXATION
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BALTIMORE, MARYLAND
JANUARY 25, 1939

REPORT OF THE COMMISSION ON
TAXATION AND REVENUE

JANUARY 25, 1939.

THE HONORABLE HERBERT R. O'CONNOR,
Governor of Maryland.

SIR:

In your public statement accompanying our appointment as members of this Commission you stated that we were selected for the "purpose of determining the best method by which needed revenues of the State can be raised, and to explore various methods of taxation and to make recommendations for the most equitable and fair forms which will be calculated to yield a sum to meet the requirements of the State".

We were advised by your Budget Commission that it will be necessary to raise \$8,500,000. for each of the first two fiscal years of your administration, to take the place of expiring taxes and to raise the additional revenue required by the budget. Included in this sum is a figure deemed sufficient to cover the cost of administering and collecting the various taxes proposed to be levied.

The raising of this large sum presents a number of serious problems. At the outset we hoped to be able to draft a permanent plan of taxation to raise the revenue necessary for the State. We encountered numerous instances of unfairness and inequalities in our present tax system. Because of the limited time at our disposal we concluded that we would confine ourselves to the immediate problem of raising the sum mentioned by the Budget Commission as being necessary.

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We are hopeful that a Commission will be appointed by you to examine the entire tax structure of the State and report to you well in advance of the next session of the General Assembly, so that ample time will be given for a careful consideration and discussion of its recommendations.

This Commission devoted a great deal of time and study to a consideration of the many tax plans proposed. We had the assistance of the officials of State Departments and had the advice of expert accountants whose service was rendered gratuitously.

There has been a full and complete discussion and examination of every plan suggested. Because of the divergent business and professional interests represented by our membership we had the views of a fair cross-section of the State.

In raising this large sum this Commission had to determine what tax, or group of taxes, could be levied with the least burden upon, or damage to, the economy of the State. It is also necessary to consider the effect of new tax measures upon the existing tax structure, and to modify that structure accordingly.

It was at once apparent to the Commission that the amount to be raised was too large to be met solely by any group of special taxes. Obviously, it was necessary to select one of the main types of general taxation to form the backbone of the program. Accordingly, the Commission was obliged to consider the three main branches, namely, the general property tax, the general sales tax, and the net income tax.

As to the first, the Commission felt that any substantial increase in the State property tax was undesirable, for a

number of reasons: (1) because the combined State and local rate is already so high as to be a drag upon the real estate market, and to be approaching the point of diminishing returns; (2) because this is the primary source of revenue for the financing of capital improvements and State bond issues; (3) because this is the only practicable source of local revenue, which should be chiefly reserved to the local political subdivisions to meet expanding needs; (4) because the tax falls upon unproductive as well as productive property, and contains many exemptions of productive property; (5) because ownership of real estate or of merely an equity in real estate is not a fair index of wealth or of ability to pay on the basis of unenumerated value; (6) and finally, because any addition to the present real estate tax rate would further increase existing inequalities in assessments. These arguments seemed to us to outweigh the fact that an increased rate would produce revenue without added administrative cost. The problem is to raise revenue with the greatest and fairest distribution of the burden.

As to the general sales tax, the Commission felt that a disproportionate burden of this tax would fall upon those least able to pay and that it would affect business adversely in the border counties. Furthermore, the general gross receipts tax of 1935 had developed such strong opposition that the enactment of a general gross receipts or general sales tax was obviously out of the question.

The Commission has therefore selected the net income tax as a main source of dependence for additional revenue. Moreover, the Commission believes that this tax, if not carried to extremes, is sound in theory, and, regardless of the needs of the moment must form a permanent part of the tax structure of the State.

The point was raised at the outset that reasons of expediency should dictate the abandonment of this revenue source, because of the adverse vote upon the proposed constitutional amendment (Ch. 525, Acts of 1937). The vote may be explained by the fear on the part of taxpayers that a favorable vote might have brought about the adoption of a graduated or progressive income tax of an extreme character. The tax we recommend is a uniform income tax, classified as to sources of income.

The Commission has no doubt as to the constitutional validity of a net income tax in Maryland of the type hereinafter recommended. The power to tax is inherent in sovereignty, and the only possible contention that could be raised against such an income tax is that it violates the uniformity clause of the Maryland Constitution. That clause, we think, is not applicable to net income taxes at all, but if it were, it would still permit reasonable classification such as we propose.

We have not proposed a graduated income tax for a number of reasons: (1) out of deference to the adverse although light vote on the graduated tax, (2) because the Federal tax has gone to such marked extremes in progressive taxation, and (3) because at the low rates proposed, a flat tax, classified as to source, accomplishes practically the same purpose. In this connection, we may point out that this type of tax has been in use for many years in Massachusetts, a State which has always enjoyed the best professional advice in its tax policies and administration.

INCOME TAX

Firstly, we propose a flat income tax of 2½% upon individual incomes from sources other than intangibles.

We propose to allow individuals the following specific exemptions: single, \$1,000; married and heads of families, \$2,000; dependents, \$400 each. In this connection, we find that married exemptions are \$2,000 or lower in more than half the States having income taxes. Moreover, we think that there is no sound reason why a married couple, having no children or dependents, should have an exemption of more than twice the single exemption. We propose no change in the dependent exemption of \$400 per dependent, although it is not higher in any State, and is lower in two-thirds of the States.

We recommend that the filing date be the same as for Federal returns, and that payments in full accompany the returns, to meet the revenue needs of the State, as the payment date is nearly six months after the State's fiscal year begins. The forms for the returns should be made as simple as possible.

We believe that this income tax should apply to the income of all state officials and suggest that proper legislation be enacted to effectuate this recommendation.

We further propose the disallowance of deductions of all income, inheritance, gift, succession, and estate taxes paid.

In regard to partnerships, we propose to disregard partnership entity, except for information purposes, and to impose the tax upon the income received by partners as individuals. This involves no change in the present law.

As to fiduciaries, we propose likewise to tax the beneficiaries on the income received, except in those cases where income is accumulated or not distributed during the taxable year. In such cases, we propose to tax the

fiduciary as under the present law, making such changes therein as will conform to the Federal Law as far as practicable. This tax should not apply to trusts administered in Maryland for non-resident beneficiaries.

We propose to eliminate altogether the tax upon capital gains, and likewise to disallow capital losses. This will result in no real loss of revenue, based on the returns for 1937 under the present Act, which taxes capital gains or allows capital losses on property held less than two years. It will, however, simplify accounting and minimize fluctuation in the annual yield.

It is estimated that a 2½% income tax on incomes of individuals, with exemptions as outlined will yield annually \$1,950,000.

Secondly, our proposal is to levy a flat individual income tax of 6% on income from dividends and interest and to repeal the present tax on intangibles, generally known as the 4½ mills tax. The present tax of 4½ mills is, in effect, a flat income tax, based on the *value* of the security taxed and not its yield, and is equal to a flat income tax averaging 8.9%. The 4½ mills tax applies only to dividend paying stocks of foreign corporations and interest bearing obligations.

While our proposal brings within the tax base income derived from investments in domestic as well as foreign (i. e. out of state) corporations, nevertheless it is most fair in its operation. The average portfolio is found to contain only 17½% of stocks in Maryland corporations: the balance namely, 82½% consists of investments now subject to the 4½ mills tax.

The result of this proposed 6% income tax means that the State of Maryland will receive a proper tax on income

from securities, and at the same time the taxpayer who has made a fair and honest disclosure of his holdings of securities subject to the 4½ mills tax, will pay less; *but*, the person who has not paid in full heretofore on his holdings will pay more. The average owner of securities in domestic corporations with the normal diversification of holdings will pay no greater tax than before.

There are grave doubts as to the constitutionality of any proposal to tax at different rates income from the shares of domestic and foreign corporations. Actually, the amount of revenue derived from the tax on the dividends of domestic corporations is a comparatively small percentage of the total and will have no adverse effect on business. Moreover, such a distinction would invite retaliatory legislation by other States.

The 4½ mills tax is unfair, and its administration difficult, and to a very great extent ineffective. The proposed plan eliminates the necessity for assessment as to valuation, since the proposed tax is to be measured by income from, and not the market value of, investments. It applies to income received throughout the year, rather than being measured by holdings on a certain date. It provides for an accurate, centralized administration, that will minimize tax evasion.

From figures and statistics we have compiled we believe that the 4½ mills tax in its practical effect has been unfair to the taxpayer who was properly assessed and has benefited unduly many taxpayers who were never properly assessed. The proposed plan will take away the present advantage in establishing fictitious or colorable residence as between local political subdivisions, and will result in no loss of revenue to them.

At present the law (with certain exceptions) provides that two-thirds of the 4½ mills tax goes to the political subdivisions, and one-third to the State. To avoid any disturbance to the local budgetary plans we recommend a return to these subdivisions of the exact amount they received in dollars averaged over the past five years from this source.

In determining the tax to be paid by the taxpayer we recommend that income from dividends and interest shall be taxed at 6%, and other income at 2½%, with a tax credit equal to 2½% of the allowable exemptions and deductions.

This income tax of 6% is estimated to yield	\$4,800,000
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From this it is necessary to allocate to the political subdivisions the amount heretofore collected by these subdivisions from the 4½ mills tax which is to be repealed. This is estimated to amount to	\$1,600,000
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Since this Commission was charged with the duty of raising new revenue, it is necessary to return to the State the same amount it has heretofore received from the intangibles tax, estimated at	800,000
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Total to be deducted and returned to the political subdivisions and the general budget of the State as above set forth by reason of the repeal of the 4½ mills intangible securities tax	2,400,000
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Amount of net new revenue from proposed 6% tax	2,400,000
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Third, as to corporations, we propose a rate of $1\frac{1}{2}\%$ payable by both domestic and foreign corporations, to avoid discrimination, but only upon income derived from sources in this State.

National Banks are taxed on their shares, and this tax is collectible out of dividends paid to shareholders. Under the Federal law, National Banks may not be taxed more heavily than State banks and trust companies. For constitutional reasons, as well as for reasons of fairness, we propose that in the case of all domestic corporations taxed on their shares, shareholders be relieved from the payment of income tax on these dividends.

Insurance companies were relieved of the share tax in 1937, and except in the case of life companies, subjected to the intangible tax; to offset loss of revenue from a repeal of the latter tax, we suggest an upward readjustment of the premiums tax on all classes of insurance companies.

The problem of fair and adequate treatment of the various classes of corporations requires study which the time at our disposal has made impossible. We recommend that a commission, as herein suggested, make a study of corporation taxes and report to the Governor. The Commission feels that while corporations should pay their fair share of the tax burden, that burden should not be so great as to drive domestic corporations out of the State, or prevent new enterprises from incorporating here. We also feel that there should be no penalty on doing business in the corporate form, as distinguished from the individual or partnership form.

It is estimated that an income tax of $1\frac{1}{2}\%$ on corporations will yield annually \$1,250,000.

OTHER TAXES.

The Commission gave careful consideration to a number of special taxes suggested, including cigarette taxes, soft drink taxes, tax on brands, public utilities consumers tax, and others. The Governor of Maryland has publicly expressed his disapproval of the licensing of gambling machines, by whatever name called. The present act which expires April 30, 1939, provided for the licensing of pin ball machines. We recommend allowing this law to expire.

After mature consideration the Commission concluded that the balance of revenue be raised from the following sources :

MUSIC BOXES

While this tax is estimated to yield only \$55,000 it is the only tax provided by the last tax program which does not expire in 1939. It is the only tax apparently made permanent by the Legislature of 1937. It applies to the commercial type of phonograph requiring the insertion of a coin for operation and is found in public restaurants, taverns, etc. We see no reason why this tax, which is at present at the rate of \$15.00 per machine, should be repealed.

MOTOR VEHICLE TITLING TAX

This tax has been in effect since 1935, and has been economical in its administrative cost, and quite fair. It is a one per cent tax on the market value of all motor vehicles for which an original certificate of title is issued by the Commissioner of Motor Vehicles. This tax is estimated to yield \$450,000 annually. We recommend the continuance of this tax.

TAX ON DISTILLED SPIRITS.

The present manufacturers' production tax on whiskey at the rate of $2\frac{1}{2}\text{¢}$ per gallon has yielded about \$250,000 annually. This revenue will decrease as the distilleries in Maryland are no longer operating at full capacity as heretofore but have accumulated large stocks. In some instances, because of this tax manufacturing has been done elsewhere to the detriment of this industry in Maryland.

We recommend in lieu of this tax an addition of fifteen cents per gallon to the present excise tax of \$1.10 on distilled spirits sold to retailers in Maryland. This is estimated to raise \$310,000 additional annually and will not increase the cost of administration.

TAX ON BEER

At present beer is taxed at the rate of $2\frac{7}{16}\text{¢}$ per gallon, approximately 75¢ per barrel. We recommend the continuance of this tax at the present rate. The estimated yield is \$860,000 annually.

TAX ON RECORDATION OF LEGAL DOCUMENTS

At present this tax yields \$235,000. It is easy to administer and generally fair in its application. It should be continued but modified to provide for a fairer interpretation as applied to long term leases and open mortgages. These modifications would not materially affect the revenue from this source.

INCREASED TAX ON RACE TRACK BETTING

In the emergency of 1933 the State enacted a law providing that 1% of the betting at the four one-mile tracks in the State be paid over to the State Treasurer, in addition to the license fees and other taxes already levied.

In 1938 the tracks obtained from the Racing Commission authority to increase their share of the betting by an additional 1% to be used for capital improvements and larger purses.

We recommend that the Act of 1933, Ch. 324 (Code, Art. 78 B, Sec. 12A) be amended to raise the rate from 1% to 2% on all bets, to be paid over to the State, and all other provisions of the law pertaining to the per diem tax, etc. be left unchanged. The estimated increased yield is \$300,000. annually.

RENEWAL OF OPERATORS' LICENSES

In 1937 a re-registration fee of \$1.00 was charged every motor vehicle operator (exclusive of chauffeurs) and this raised \$410,000.00. Operators who obtained new licenses in 1937 were not required to pay this charge. As a result of a recent decision of our Court of Appeals a large proportion of those who heretofore were required to renew chauffeur's licenses at an annual charge of \$3.00 will no longer be required to do so.

We recommend a license fee of \$2.00 to each motor vehicle operator (exclusive of chauffeurs) to be collected during the fiscal year ending September 30, 1941. We believe that from the point of view of public safety it is imperative that there be a periodic re-examination of all motor vehicle operators. We believe that the examinations can be made with a minimum of inconvenience to the public, and if begun October 1, 1940, could be fully completed by September 30, 1941. The Commissioner of Motor Vehicles should be given discretion to establish dates for examination in the various counties and by spreading the work over the year a last minute rush can

be avoided. By setting dates beyond which licenses would be void various groups of operators can be examined without causing congestion.

The examination should consist of answers to a questionnaire, examination of eyes, and in the discretion of the Commissioner where physical defects are discovered, a complete driving test.

It is estimated that after allowing for those who fail to pass the examination and for other contingencies, the revenue raised will be at least \$1,000,000. Since this all comes in the second year of this biennium it will be necessary to adjust the accounts of the State Treasurer accordingly. This means \$500,000 new revenue for each of the two years for which this report is prepared. We suggest that this tax go into effect for the second year of the biennium so that there will be a lapse of three years since the payment of the charge of \$1.00 per operator in 1937.

TAX ON PASSES AND ADMISSIONS.

The present tax on admissions raises \$230,000 annually of which sum \$78,000.00 comes from taxes on passes. In the case of moving picture theatres, at the request of the proprietors, the Legislature allowed them to absorb the tax, and it was not passed on to the public.

We recommend that the law be continued but that school and college plays, church affairs, and other similar non-professional groups, not regularly in the entertainment business, be exempt. This will result in no substantial loss of revenue but will reduce the cost of administration considerably. We estimate that this tax will raise \$220,000.00 annually.

SUMMARY OF TAXES***Income Taxes***

2½% tax on net income of individuals, (exclusive of income from dividends and interest) estimated to yield an- nually	\$1,950,000
Taxes on dividends and interest at the rate of 6% per annum, estimated to yield annually	\$4,800,000
Deduct from this estimate the amount required to replace the yield from the 4½ mills tax which is to be repealed; this sum to be returned to the politi- cal subdivisions and the State..	2,400,000
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Net total from this tax...	2,400,000
1½% tax on net income of corpora- tions, estimated to yield annually	1,250,000
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Total	\$5,600,000

Other Taxes

(all Estimates on annual yield)

Motor vehicle titling taxes	450,000
Tax on music boxes	55,000
Beer tax @ 75c per barrel	860,000
Tax on recordation of legal documents..	235,000
Additional tax on distilled spirits at 15c per gal.	310,000
Increased tax on race track betting....	300,000
Tax on passes and admissions	220,000
Renewal of operators' license	500,000
	<hr/>
Total	2,930,000
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Grand Total	\$8,530,000

OTHER RECOMMENDATIONS.

The Commission deems it appropriate to make certain other comments upon the existing tax structure of the State. While not directly related to the problem of raising additional revenue, they demand consideration in the near future.

1. Existing defects in the franchise tax law are a source of expanding revenue loss and should be corrected.

2. The law dealing with the tax on the gross receipts of railroads and public utilities should be revised to meet objections which have been raised under decisions of the Supreme Court.

3. The system of allocating the tax on tangible personal property of ordinary business corporations, according to the residence of stockholders is anomalous, unsound in theory, and adds unnecessarily to the administrative burden of the State Tax Commission. Whatever purpose it once served has been eliminated by the growth of industry in the counties adjoining Baltimore City. We recommend the repeal of this allocation provision, in order that tangible property shall be assessed and contribute its share to the local subdivision where it obtains its protection.

4. There should be an amendment to the inheritance tax law, to provide for an exemption of \$150.00 on all legacies or bequests (now \$100.00), and this should be extended to property passing by succession in joint accounts, and by intestacy. This would eliminate a great number of trifling reports and collections, not justified by the yield, but annoying to taxpayers in the lower brackets.

The exemption from inheritance tax of property in joint bank accounts passing to husband and wife, should be extended to other types of property so held.

5. Most important of all, we recommend that the State Tax Commission and the local tax authorities concentrate upon the equalization of property assessments throughout the State, to the end that every property owner should pay his just share proportioned to the fair value of his taxable property. More than anything else this will make the public tax-conscious and crystalize public opinion behind the growing insistence upon fair, just and impartial tax administration. We recommend that the wise policy of periodic general re-assessment, instituted with the creation of the State Tax Commission in 1914, be rigidly adhered to hereafter.

AVOIDANCE OF RECURRING DEFICITS.

Another problem, not directly related to the immediate one before this Commission, is yet so inseparable from the general tax problems that we feel obliged to comment upon it.

The fundamental reason why it is necessary to raise additional revenue is because the State over the past six years has assumed permanent obligations under the head of Social Security and relief, to the extent of at least five million dollars annually, and other governmental obligations, including an increased burden in the school equalization fund, and additional maintenance charges for State-owned and State-aided institutions, to the extent of three million dollars. The decrease in existing State revenues incident to the business recession, plays only a minor part in this situation.

We believe that our program will meet the recurring-deficit problem. But the taxpayers must realize that State obligations cannot be extended to any degree, without precipitating another revenue crisis. Any further increase in State taxes will be extremely unsettling to business, and will act as a powerful deterrent to the establishment of new business enterprises in Maryland. The constant threat of future tax increase, which cannot be estimated in advance, is infinitely more harmful to the State economy, than the amount of the existing burden at any one time.

We therefore urge that no additional taxes be levied for the next four years unless absolutely necessary and inescapable. We do not oppose changes designed to adjust the existing burden in a more equitable way, but we oppose any further increase in the tax levy. The State of Maryland must go on a pay-as-you-go basis, and the administration and the public must be alert to resist the natural pressure for additional current expenditures (beyond the point where they may be paid out of administrative savings), and for new capital expenditures, which increase maintenance charges.

The Commission desires to express its thanks and appreciation to William L. Henderson, Deputy Attorney General, for his aid and assistance. He was of great help to us and rendered valuable service.

The Commission acknowledges also the helpful services and courteous cooperation of the following :

Hooper S. Miles, State Treasurer ;
Joseph O'C. McCusker, Chief Deputy Comptroller ;
Albert W. Ward, Secretary, State Tax Commission ;
Carl L. Wannan, Chief, State Income Tax Division ;

Owen R. E. McGeeney, Auditor, Commissioner Motor
Vehicles ;

C. C. Croggon of Haskins and Sells, Certified Public
Accountants.

Respectfully submitted,

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HUNTINGTON CAIRNS,
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L. MANUEL HENDLER,
OLIN R. HIGGINS,
WILLIAM H. LABROT,
WILLIAM PRESTON LANE, JR.,
OSCAR LESER, [with reservations]
to be explained]
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JOSEPH P. MCCURDY,
GEORGE R. MORRIS,
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