

Veto No. 10

HB 314

July 9, 1976

To the Honorable, the House of Representatives
of the Commonwealth of Pennsylvania:

I return herewith, without my approval, House Bill No. 314, Printer's No. 3549, entitled "An act amending the act of March 4, 1971 (P.L.6, No.2), entitled 'Tax Reform Code of 1971,' further defining 'dividends' and 'compensation,' and providing for taxation as personal income on installment payments of real and personal property and further providing for tax returns."

House Bill No. 314, if enacted, would almost certainly result in substantial loss of revenues, a finding of unconstitutionality and extreme administrative burdens. For these reasons, I cannot approve its enactment.

House Bill No. 314, Printer's No. 3549, would amend the Personal Income Tax portion of the Tax Reform Code in four areas:

SPECIAL TAX PROVISIONS - NO RETURN REQUIRED. The proposed amendment to section 330 would provide that "no return shall be required if the taxpayer has no tax due by reason of application of special tax provisions." While at first glance, this would appear to be a common sense approach, there are insoluble difficulties in its implementation. The Special Tax Provision is a "credit" rather than an "exclusionary" mechanism. *Only* by completing a tax return can the Special Tax Provision be applied. Under the law, any person who receives taxable income is liable for payment of the tax. The Special Tax Provision is one of several ways of establishing full or partial *credit* against the payment of the self-determined tax liability; therefore, this Special Tax Provision credit *cannot* be applied where no return is filed. Unless a claim for this credit is made on the tax return, the Department of Revenue would have no control over the authentication of claims for the credit. There is every reason to believe that numerous taxpayers would incorrectly or wrongfully assume their eligibility for the Special Tax Provision credit and fail to file a return. This provision alone would be so subject to abuse that it could result in a substantial loss of revenues. In addition, the Department of Revenue would be deprived of certain basic information and statistics which are absolutely necessary in the estimation of revenues, determination of distribution of income and the total amount and number of taxpayers eligible for the Special Tax Provision tax credit.

UNREIMBURSED EXPENSES EXCLUDED FROM COMPENSATION. The proposed amendment to section 301 (b) would exclude from the definition of the term "compensation" any and all "reasonable and necessary actual expenses expended pursuant to the production of income and not otherwise reimbursed." I note that this language results from an amendment included by the Conference Committee; however, rather than answer the criticisms directed at the

previous language for its ambiguity, this amendment results in even more potential for abuse and is therefore subject to even greater loss of revenues than was the previous language. In addition, it is far more likely to be found unconstitutional by the Supreme Court. This, of course, will benefit no one.

I recognize that there are certain individuals in the Commonwealth who face the difficulty sought to be resolved by House Bill No. 314, that is, they are W-2 wage or salary earners who must expend a portion of their W-2 income in the production of that income without being reimbursed. The Tax Reform Code makes no provision for the deduction or exclusion of unreimbursed expenses. The primary difficulty in providing for the exclusion of these unreimbursed expenses is that such provisions invariably run afoul of the court's pronouncements regarding uniformity of tax laws. This, of course, is the same stumbling block which stands in the way of the far more progressive graduated income tax which I have proposed on numerous occasions.

As I am sure you will recall, the Supreme Court of Pennsylvania found the original Personal Income Tax Law unconstitutional in *Amidon vs. Kane* in which the court stated in part, "natural persons, on the other hand, cannot be likened to profit maximizing entities. Individuals spend their resources for an infinite variety of reasons unrelated to the making of a 'profit.' Thus, unlike the corporate context, *it would be exceedingly difficult, if not impossible to create a Personal Income Tax designed to take into account the 'cost' of producing individual income.*"

The Commonwealth Court recently explained that allowing a deduction for unreimbursed expenses would impose a tax only upon spendable compensation as opposed to a tax on gross income which is the foundation of the Personal Income Tax system. The proposed change in the definition of "compensation" would necessitate the creation of an additional classification of compensation. Such a classification would constitute an unreasonable and impractical one in that it would benefit the unreimbursed employee over one who is reimbursed by his company since the former would have control over what constitutes "necessary" and "reasonable." This, in turn, would further exacerbate the non-uniformity of this particular provision.

I note that most of the terms used in this short amendatory provision are virtually incapable of being adequately defined. It is this inherent ambiguity which results in such a tremendous potential for abuse that the category of income known as "compensation" could theoretically be eliminated as a portion of the Personal Income Tax base. This, of course, would severely decrease General Fund revenues.

Furthermore, in view of the virtual certainty that the Supreme Court will find this provision unconstitutional as soon as it is challenged, a serious question arises as to whether the enactment of this measure into law, because of the benefits which may result, is such a futile act that it should not be undertaken.

INSTALLMENT SALES. The proposed amendment to section 303 (a) would provide that "in the case of installment sales of real or personal property the taxable gain recognized in any year shall be that portion of the total gain that the installment payment in any such year bears to the total sales price to be paid over the entire installment period." While the Internal Revenue Service has a similar provision with regard to the Federal Income Tax, it must be remembered that there is no requirement of uniformity in the Federal system. Furthermore, the Internal Revenue Code and the Internal Revenue Service regulations, contain numerous guidelines which set forth precisely how this provision is implemented on the Federal level. There are no guidelines in House Bill No. 314 which would allow the Department of Revenue to accurately and equitably administer this provision. The lack of definition and clarity would render this amendment virtually impossible to implement.

Because of the potential for substantial revenue loss as a result of fraud arising from the proposed changes in the Personal Income Tax and the other reasons given above, I return herewith, without my approval, House Bill No. 314, Printer's No. 3549.

MILTON J. SHAPP