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## DEVELOPMENTS IN PENNSYLVANIA CORPORATE TAX PROCEDURE

by

I. H. KREKSTEIN\*

### I

#### INTRODUCTION

During the past several years the Commonwealth has made a planned effort to impose restrictions and limitations on certain remedial procedures of corporate taxpayers. This comes to light in looking behind the scenes of some recent decisions.

Before doing so, it should be noted that the general corporate tax procedures are provided in the Fiscal Code of April 9, 1929, P. L. 343, as amended. The Corporate Net Income Tax Act of May 16, 1935, P. L. 208, as amended and reenacted and, provides procedures peculiar to that tax, but is otherwise linked to the Fiscal Code.

The campaign was in the form of a two pronged attack against the following:

- 1) The five year statutory period for filing Petitions for Refund.
- 2) The right of the taxpayer to raise new issues in reports of change in corporate net income.

So far it would appear that the Commonwealth has been on the losing side of the fight against the five year refund period, but is the victor in its first skirmish with the question of raising new issues in reports of change.

These subjects raise not only interesting legal questions, but also questions that affect the taxpayer's pocketbook. In this discussion an effort will be made to sketch in more or less chronological order the events and cases that have a bearing on the subjects.

### II

#### CLAIMS FOR REFUND

##### 1. *Statutory Period*

The refund provisions appear in Section 503 of the Fiscal Code. As provided in this section, Petitions for Refund are filed with the Board of Finance and

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Revenue within two years from the date of the payment of the disputed tax or the date of the settlement, whichever date last expires. The period, however, is one year if the issue concerns valuation, and five years if the payment was made "under a provision of an Act of Assembly subsequently held by a final judgment of a court of competent jurisdiction to be unconstitutional, or under an interpretation of such provision subsequently held by such court to be erroneous."

Thus, it is obvious that whenever a case is decided by the courts against the Commonwealth, taxpayers are given a chance within five years instead of two years to recover taxes paid in good faith and which the courts decide were illegally collected.

For reasons not difficult to understand since the need for revenue exists, the Commonwealth has under certain circumstances attempted to make the five year period ineffective. Before discussing these circumstances and the cases that resulted, it might be in order to give some background.

The primary purpose of the five year rule is to offset the possible loss to the taxpayers occasioned by the delay incident to the appeal processes. It frequently takes more than five years for a final decision on a corporate tax case in Pennsylvania. This may be illustrated by reference to *Commonwealth v. Curtis Publishing Company*, decided November 22, 1949 by the Pennsylvania Supreme Court. That case raised the question whether the Commonwealth had the right to include interest on U. S. securities in the measure of the corporate net income tax. Such interest was first included in tax settlements for the year 1941. Since then taxpayers have filed returns covering eight years in which the issue could have been involved. To those taxpayers just learning that the tax was illegally collected by the Commonwealth, there might be forever lost the value of the tax for three of the eight years. It may also be noted that there will be further delay in the event that the Commonwealth attempts an appeal to the United States Supreme Court.

At the time the refund periods were established, five years might have been enough time for cases to be decided. Now, this and other cases seem to indicate that five years is frequently inadequate and two years would be far from sufficient.

After an appeal is filed with the Dauphin County Court, as provided in Section 1104 of the Fiscal Code, counsel for the taxpayer has an opportunity of discussing the issue with the Attorney General's office prior to trial. Frequently, agreements are reached and trial avoided. This is accomplished by entering into a stipulation for judgment either in favor of the Commonwealth or the taxpayer, as the case may be. The stipulation is filed with the Prothonotary of the Dauphin County Court and terminates the proceedings.

When cases are settled in this fashion, the judgment does not serve as a holding in the sense of enabling the five year rule to operate. This question was decided by the Dauphin County Court in *United Wallpaper Factories v. Wagner*,

et al. (59 Dauphin 345 - August 23, 1948). Undoubtedly, the Commonwealth considers this factor when deciding whether to close a case by stipulation for judgment or by trial.

## 2. Formal Opinion No. 572

An attack on the five year rule was made when in Formal Opinion No. 572 issued on November 25, 1947, the Attorney General held:

1) That the two year and not the five year rule applies when the tax was paid after the case involving the issue at point was decided by the courts.

2) That a case relied upon is not a holding as intended under the five year rule if judgment was entered by the court after decision was rendered in favor of the taxpayer pursuant to a stipulation filed in which it was agreed to withdraw the exceptions.

These questions came before the court on a mandamus action in *Calgon, Inc. v. The Board of Finance and Revenue of the Commonwealth of Pennsylvania*, (60 Dauphin 97). The Dauphin County Court decided on April 25, 1949 in favor of the taxpayer.

As for the first point, the court decided that a "taxpayer is entitled to a refund of moneys erroneously paid to the Commonwealth under an interpretation of an Act subsequently held by a court of competent jurisdiction to be erroneous, provided that a petition therefore is filed within five years of the payment." Thus, it made no difference whether the tax was paid before or after the decision.

As for the second point, the court ruled that *The Bell Telephone Company* case (55 Dauphin 321), a final judgment was entered. Therefore, the technicality raised by the Commonwealth that the judgment entered was pursuant to an agreement to withdraw the exceptions had no effect.

In *The Bell Telephone Company* case, the taxpayer appealed from an interest settlement based on a tax deficiency arising from a resettlement giving effect to a change in income made by the Federal Government. It was computed at the rate of 6% per annum from the date payment of the tax was originally due to sixty days after the tax settlement was made, and thereafter at 12%. The Dauphin County Court entered judgment against the Commonwealth, which was to become effective thirty days later unless exceptions were filed. While the exceptions were pending, the Legislature amended the Corporate Net Income Tax Act and provided that no interest is due on tax deficiencies arising from changes in income of the taxpayer by the Federal Government until thirty days after the report of change is due.

This provision was practically the same as the conclusion of the court in *The Bell Telephone Company* case. As a consequence, the Commonwealth entered into a stipulation with counsel for the taxpayer agreeing to withdraw the ex-

ceptions. The stipulation was presented to the court, whereupon an order was entered withdrawing the exceptions and entering final judgment against the Commonwealth. It was this judgment which the Attorney General ruled was not a holding as contemplated under the five year rule.

### 3. *Confession of Judgment*

Another attack occurred when the Attorney General attempted to confess judgment against the Commonwealth in the case of *Commonwealth v. Central Railroad Company of New Jersey*, (57 Dauphin 255 - 1946), affirmed by the Pennsylvania Supreme Court on January 5, 1948 (358 Pa. 326).

While the appeal was pending, the Attorney General had written an opinion holding that gross receipts of the type therein involved were not subject to the Pennsylvania gross receipts tax.

In order to confine any refund claims that might develop to a two year period, the Attorney General filed a paper with the Prothonotary of the Court purporting to be a confession of judgment against the Commonwealth, hoping by that process to terminate the appeal and thus prevent the court from entering final judgment against the Commonwealth as contemplated under the five year rule in Section 503 of the Fiscal Code.

The court held that the Commonwealth has no authority to confess a money judgment against itself, either under the common law or under any statute. The judgment was stricken off. Thereafter, the court decided the case on its merits and entered judgment against the Commonwealth, with the result that the holding of the court made the five year rule operative.

### 4. *Consent Judgment*

Not satisfied with this, the Attorney General tried another scheme. This appears in *Commonwealth v. First National Bank of Easton*, decided by the Dauphin County Court on May 31, 1949. The case concerns itself with shares tax for the year 1939 in which the Commonwealth among other things, not pertinent to the real point, disallowed the use of the actual or market value of assets in place of book values in determining the taxable value of the shares of the bank. While the case was pending and before trial, the Commonwealth decided to change its position in respect to the appraisal of bank shares. So as to confine refund petitions to the two year period, an attempt was made to settle the appeal by stipulation for judgment. Failing this, a confession of judgment as in the case of *The Central Railroad Company of New Jersey* was entered with the Prothonotary in favor of the taxpayer, to which the taxpayer took exception by petition to the court for a rule on the Commonwealth to show cause why the judgment should not be stricken off. That was in December 1945.

In July 24, 1947, relying on a prior decision by the Dauphin County Court in *The Central Railroad Company of New Jersey* case, a decree was entered striking

off the judgment. The Commonwealth appealed to the Pennsylvania Supreme Court, but withdrew the appeal when the decision in *The Central Railroad Company of New Jersey* case was affirmed. That was in April 1948.

Thereupon, in October 1948, the Commonwealth petitioned the court and was granted a rule on the taxpayer to show cause why a judgment should not be entered against itself by consent. Obviously, the taxpayer would not agree to such a judgment, since, in the first instance, it had refused to enter into a stipulation for judgment and had resisted the Commonwealth's attempt to confess judgment. To have agreed would in effect be limiting itself to refunds for only two years instead of five years if the case would be decided by the court in the normal manner, and judgment was entered that way against the Commonwealth.

The court in deciding on the rule took note that the Commonwealth was in agreement with the contention of the taxpayer regarding the amount of the tax that was due and was willing to concede the points originally raised, in part saying:

"What the Commonwealth is attempting to do is to indicate to the court the type of judgment which it should enter in this case to the end that the Commonwealth's position in possible future claims for refund may not be jeopardized."

The rule to show cause why a consent judgment should not be entered was dismissed and judgment was directed to be entered in the usual manner.

Again, the Commonwealth's attempt to tinker with the five year rule was blocked. As previously indicated, from a practical point of view, the five year rule is hardly enough. This is not only because appeals frequently take more than five years, but also because taxpayers have little opportunity of learning about pending litigation until a case is decided by the Dauphin County Court. Even then, there is little attendant publicity with the result that frequently the five year period elapses before the taxpayer not only learns that an issue existed, but that it was decided by the court.

### III

#### REPORTS OF CHANGE IN CORPORATE NET INCOME

##### 1. *Statutory Provisions and Previous Practices*

Until late in 1947 there was not much doubt that a taxpayer had the right to file a petition for review with The Board of Finance and Revenue under the provisions of Section 1103 of the Fiscal Code from any resettlement made by the Department of Revenue, and that no restrictions were imposed on the issues that could be raised. As a matter of practice, the Board of Finance and Revenue drew no distinction between resettlements made pursuant to Sections 1102 and 1105 of the Code or under the provisions of Sections 7 or 8 of the Corporate Net Income Tax Act. Whenever a resettlement was made, it was assumed that the taxpayer's proper remedy was to file a petition for review.

The reason for this is that the Attorney General on January 27, 1930 advised the Board of Finance and Revenue as follows:

"The procedure set forth in Sections 1103 and 1104 is applicable after resettlements have been made under Section 1105."

Section 1105 of the Fiscal Code gives the Department of Revenue the right to make a resettlement within two years of the date of any settlement and the Code neither in that section nor any other section specifically provided a remedy for the taxpayer. That is why the Board asked for and received advice from the Attorney General on this point.

By way of explanation, it should be noted that Section 1102 provides for petitions for resettlement within ninety days of any settlement; Section 1103 for petitions for review to the Board of Finance and Revenue within sixty days from a resettlement or refusal to grant the claim raised in a petition for resettlement; and Section 1104 for appeals to the Dauphin County Court from actions taken by the Board of Finance and Revenue on petitions for review.

Section 7 of the Corporate Net Income Tax Act requires taxpayers to report all changes in the net income previously returned to the Federal Government within thirty days of the receipt of notice of such change and provides penalties for failure to do so. The Department of Revenue with the approval of the Department of the Auditor General is required to make a resettlement giving effect to such changes.

Section 8 provides in Subsection (a) for the settlement of all taxes due under the Act by the Department of Revenue, and in Subsection (b) that such tax

"shall be settled, resettled and otherwise imposed and adjusted in the same manner, within the same periods of time, and right of resettlement, review, appeal, and refund, as provided by law in the case of capital stock and franchise taxes imposed upon corporations."

This is the only direct link between the Corporate Net Income Tax Act and the Fiscal Code.

In Subsection (c) the Commonwealth is given the right within two years of the date of settlement or at any time if the net income of the taxpayer is changed or corrected by the Federal Government, to make a resettlement.

The following identical provisions appear in Section 1105 of the Fiscal Code and Sections 7 and 8 of the Corporate Net Income Tax Act:

"Whenever a resettlement shall have been made hereunder, the department shall resettle the account according to law, and shall credit or charge, as the case may be, the amount resulting from such resettlement upon the current accounts of the corporation with which it is made."

It is therefore not strange, in light of the similarities in the provisions appearing in each section of the Acts concerned, and the fact that no specific statu-

tory provision was made for a remedy from a resettlement made under either section, that the Commonwealth concluded that the remedies of the taxpayer were identical. As a result, the Board of Finance and Revenue considered petitions for review under Section 1103 as the proper remedy for taxpayers dissatisfied with resettlements made under the provisions of Sections 7 or 8 of the Corporate Net Income Tax Act in the same manner as those made under Section 1105 of the Code.

As a further result, the Department of Revenue saw no point, when making resettlements giving effect to reports of change in corporate net income, in making a distinction between income and the allocation fractions. That was because the Board of Finance and Revenue, it was believed, was required to consider all issues in a petition for review from the resettlement. Therefore, it seemed that it would be imposing an unnecessary burden to compel the taxpayer to file a petition for review in order to obtain the same relief that could have been effected in the first instance.

Thus, for many years after the passage of the first Corporate Net Income Tax Act in Pennsylvania, it was the established practice of the Department of Revenue to make resettlements giving effect to reports of change without any distinction between the issues raised. The Board of Finance and Revenue considered petitions for review from such resettlements in a similar manner.

## 2. *Commonwealth v. Abrasive Company*

It is difficult to ascertain the exact date, but sometime late in 1947 the practice was changed. This comes to light in *Commonwealth v. Abrasive Company*, No. 72 Commonwealth Docket 1944, decided by the Dauphin County Court on May 23, 1949.

This case involved a corporate net income tax report for the calendar year 1940 which was duly settled by the Department of Revenue and approved by the Department of the Auditor General on August 7, 1942. No petition for resettlement was filed within ninety days as was provided in Section 1102 of the Fiscal Code, but on April 15, 1943 a report of change in corporate net income was filed with the Department of Revenue.

This was prior to the passage of the Act of May 7, 1943, (P. L. 217), which removed from the prior Act the requirement to file a petition for resettlement in addition to a corrected report. This is not mentioned in the opinion and therefore it is unknown whether a petition for resettlement was filed with the report of change.

The report of change showed a reduction in the net income originally reported and also revisions in the wages and salaries and gross receipts allocation fractions. These revisions in the fractions were not due to the change in the net income returned to or ascertained by the Federal Government.

A resettlement was duly made and approved August 25, 1943 by the Auditor General's Department giving effect to the reduced income, but no changes were made in the fractions.

It should be noted that the resettlement was made before two years from the date of the original settlement had elapsed. Thus, the Department could have made a resettlement at that time, not pursuant to the provisions of Section 7(b), but under the provisions of Section 8(c) of the Corporate Net Income Tax Act or Section 1105 of the Fiscal Code, increasing or decreasing the tax. There is little, if any, doubt but that in such a resettlement the Commonwealth would have been authorized to change the fractions if they were incorrectly stated in the original settlement.

The taxpayer filed a petition for review with the Board of Finance and Revenue on October 25, 1943 requesting use of the revised fractions. This petition was refused on January 6, 1944, from which refusal an appeal was taken to the Dauphin County Court.

It should also be noted that a petition for refund could have been filed with the Board of Finance and Revenue at any time prior to August 7, 1944. That is because it was within two years from the date of the settlement or payment of the tax, whichever date last expired, as provided by Section 503 of the Fiscal Code under the amendment of May 7, 1943 (P. L. 229), effective July 1, 1943. Prior to this amendment, a petition for refund had to be filed within two years of the date of payment without regard to the date of settlement.

The points at issue were:

1. Is the Commonwealth in the resettlement required to give effect to the revisions in the allocation fractions which were not caused by the change in income?
2. Upon failure of the Departments to do so, was the Board of Finance and Revenue required to make a resettlement giving effect to said revised fractions on a petition for review of the resettlement?

The taxpayer contended that the making of a resettlement "according to law" pursuant to the provisions of Section 7 of the Corporate Net Income Tax Act means that such a resettlement must be made according to the substantive provisions of the Corporate Net Income Tax Act. Therefore, the resettlement must correct any errors that might have been made in the original settlements, even though the error in the settlement was due to error in the original report.

Accordingly, by making a resettlement in which the fractions are not correct, the Commonwealth made a resettlement which was not "according to law."

However, the court disposed of this contention stating that the taxpayer had "confused a resettlement pursuant to a report of change as provided by Section

7, with a resettlement made pursuant to a petition for resettlement generally, as provided by Section 8(b) of the Act."

The fact that the language in Section 7(b) and 8(c) in which the resettlement is required to be made "according to law" is identical, was not discussed in the opinion.

The court took the position that the purpose of a report of change is to show the net income as finally changed or corrected by the Federal Government and that a resettlement under Section 7 in which effect if given thereto should only cover the change in income. As to this point, the court said in part:

"The sole purpose of the resettlement provided by Section 7 is to make such adjustment in the tax of a corporation as may be occasioned by a change in income."

It might be taken from the above quoted statement that the resettlement could cover not only the revised income, but could also encompass the allocation fractions if the adjustments of the income or deductions by the Federal Government also affected the allocation fractions.

The court pointed out that the taxpayer had two remedies, neither of which was used. One was a petition for resettlement under Section 1102 and the other a petition for refund under Section 503 of the Fiscal Code. Therefore, the court believed the taxpayer was attempting to accomplish by indirection under Section 7 what it could no longer accomplish under Section 8.

No consideration was given to the fact that the taxpayer was within the required time for filing a petition for refund when it filed the petition for review.

There is no way of determining whether knowledge by the court that the taxpayer was in time for filing a petition for refund under Section 503 would have had any effect on the decision. However, it is apparent that two courses appeared to be simultaneously open to the taxpayer. One was a petition for review under Section 1103 and the other a petition for refund under Section 503. The taxpayer chose the former.

Since a remedy other than the one attempted was available to the taxpayer, it would not seem that an attempt was made to do by indirection what could not have otherwise been done. It should be noted that both a petition for review and a petition for refund are filed with the Board of Finance and Revenue. If, by the taxpayer's choice of one over the other, the Commonwealth is permitted to refuse refund of the taxes in controversy, then it is only by reason of the barest of technicalities.

As to the second point raised by the taxpayer, the court held that the Board of Finance and Revenue was not required to consider in a petition for review issues which could not be raised in the first instance. The court had reference in this

respect not only to the report of change, but also to a petition for resettlement under Section 1102 of the Fiscal Code. The reason for pointing to a petition for resettlement is that the period of time for filing such a petition had expired. Therefore, by filing a petition for review from a resettlement made on a report of change, the taxpayer was in effect extending the time limit for seeking a resettlement.

Here again, no consideration was given to the fact that a petition for refund could have been filed at the time that the petition for review was filed.

The taxpayer's position for contending that the Board of Finance and Revenue had authority for making a resettlement on the basis of issues other than the federal changes was that Section 1103 of the Fiscal Code, the section governing petitions for review, places no limitation upon the questions that a taxpayer may raise or which the Board may consider. However, the court was not convinced that this also was not a means of extending the limits of the taxpayer for adjusting its tax liability.

As was previously explained, the taxpayer, according to the 1930 opinion by the Attorney General, is permitted to file a petition for review to the Board of Finance and Revenue under Section 1103 from any resettlement made under Section 1105. Such a petition may include issues other than the one which served as the basis of the resettlement.<sup>1</sup> The effect of consideration of a petition for review by the Board under such circumstances can be and frequently does extend the time limit of the taxpayer within which to pursue a remedy.

Section 1103 of the Code was amended on April 25, 1949 in Act No. 183. This was while the court was considering the *Abrasive Company* case and about a month before it was decided. The amendment specifically provided that a petition for review may be filed from a resettlement made under Section 1105. By this the legislature added a provision to the statute that conformed with the previous ruling of the Attorney General and with what had been the practice of the Board of Finance and Revenue since 1930. As the matter now stands, exceptions have been filed and are awaiting final action by the Dauphin County Court.

### 3. *Points not Raised in the Abrasive Case*

In addition, other appeals have been filed, one of which is *Commonwealth v. Sterling Varnish Co.* (No. 200 Commonwealth Docket 1948). In these cases the Departments have refused to include in the resettlement and the Board of Finance and Revenue has refused to consider in a petition for review revised fractions appearing in the reports of change even though these revisions resulted from changes in the net income made by the Federal Government.

Probably the court will have a better opportunity of judging the issue after consideration has been given to the broader aspects which will be developed in the trial and argument of the later cases.

The fundamental question is deeper than it would appear from the *Abrasive Company* case. The real point at issue is whether a tax account when it is opened by the Commonwealth, particularly when it results in additional tax, can under the law leave the taxpayer without a remedy. The *Abrasive* case was not broad enough in scope to enable the court to view the inequitable situations that might develop.

The report of change in the *Abrasive* case reflected a decrease in taxable income. Would the court's conclusion have been the same if the income had been increased? Section 8(c) provides for resettlements if the change in the net income of the taxpayer by the Federal Government results in additional tax. In the event of such a revision in income, would the resettlement have been made under the provisions of Section 7 or Section 8? In the event that the resettlement was made under the latter section in which there is a provision for Fiscal Code remedies, would the taxpayer have had the right to take exception to the resettlement by means of a petition for review under Section 1103 of the Code in which other issues are raised?

Suppose the original corporate net income tax return of the taxpayer reflected no taxable income, for which reason no out-of-state allocation was claimed, and a settlement was made by the Commonwealth in which no tax liability appears. Later the Federal Government examined the records of the taxpayer and disallowed or adjusted certain deductions so that taxable income was reflected. In due course the taxpayer filed a report of change in which taxable income is indicated and in which out-of-state allocations are claimed for the first time. The out-of-state allocations were not the result of revisions in the net income, but allocations that originally applied, but were not claimed. The report of change was filed beyond the statutory period for filing a petition for resettlement or a petition for refund. Would the Commonwealth be required to consider these allocation fractions in the resettlement pursuant to the report of change? If not, would the Board of Finance and Revenue be required to do so on a petition for review filed within sixty days of the resettlement? Or, would the taxpayer be left without a remedy?

Or, simply suppose the Commonwealth in making a resettlement on a report of change made an error against the taxpayer that had no relationship to the revised income and the time had expired for a petition for resettlement or a petition for refund. Would the taxpayer be left without a remedy? These are a few of the unsettled questions that will in due time come before the court and are in addition to the ones raised in the *Abrasive Company* case.