The Corporation's Liability for the Pennsylvania Corporate Loans Tax

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By

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The present tax in Pennsylvania on corporate loans is imposed by the Act of June 22, 1935 P.L. 414. Although commonly called The Corporate Loans Tax, the law does not in the majority of cases impose any tax upon the corporation, but rather, except in certain special instances, imposes a tax upon individuals. It is the purpose of this article therefore, to point out those special instances when the corporation itself is liable for the tax.¹

The Corporate Loans Tax is in essence a tax upon certain individual creditors of corporations having a resident treasurer or fiscal officer.²

"It certainly must be conceded that the corporate loans tax can in no sense be considered as a tax upon the corporation, its property or its franchises; it is *** a tax upon the property of the individual citizens of the state."

Commonwealth v. Lehigh Valley Railroad Co., 104 Pa. 89

"It certainly must be conceded that the corporate loans tax can in no sense collecting agent for the Commonwealth in collecting from the individuals the tax due. The corporation is in effect the tax collector.

"It is primarily a tax on the property of individual residents of Pennsylvania and the corporation doing business in Pennsylvania is made the collector for the State." Commonwealth v. Jessup and Moore Paper Co. 31 Dauph. 273.

This it is true, is normally the case, but there does exist certain sets of circumstances and instances when the corporation itself must pay the tax due. It is with these that we are interested.

The first and probably the most obvious instance when the corporation itself is liable for the Corporate Loans Tax is when by contract or by the terms of the loan itself the corporation assumes the liability for the tax. Under these conditions the corporation itself is liable for payment and it matters not to the taxing auth-

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¹ The field of Pennsylvania corporate taxation is very broad. The Corporate Loans Tax itself is extensive and in a great many instances quite complex. For this reason, any general discussion of the determination of the tax, persons or property taxable, or manner of computing the tax would be here out of place. It is not the intent of the author here to attempt to devise a short cut method or rule of thumb for determining the tax liability initially but rather to limit the discussion to those specific instances when, once the tax has been determined, the corporation as an entity is primarily liable for its payment.

² Section 19 and 20; Act of June 22, 1935 P.L. 414.
ority what terms exist between the parties, for their tax is collectable in the first instance from the corporation. There are of course many types of loans contracts embracing a variety of terms which make the corporation liable for "any and all taxes" incident to the loan or make the loan "free and clear of taxes" and it matters not that the agreement may be general or that it may refer specifically to the Pennsylvania Corporate Loans Tax if the corporation agrees to be liable it is liable.8

The second instance when the corporation itself is primarily liable for the Corporate Loans Tax arises out of its failure or neglect to collect the tax.4 The reason for this policy has been clearly explained by the courts in the case of Commonwealth v. Delaware Division Canal Company 123 Pa. 594 where Clark J. speaking for the court said,

"The act constitutes the company or its treasurer, as such, the collector of the tax, and, upon failure to discharge the duty imposed by law, the settlement is properly made against the company, whose servant he is, as in the case of the default of any other officer of the government, upon whom a like duty is imposed."

It also appears quite evident that the liability is attached to the corporation whether or not its not having collected the tax is due to a refusal to collect,6 a failure to collect,6 negligence,7 or default of the corporation officer chargeable with collection.8 The duty upon the corporation is clear and precise. Failure to perform that duty, whether due to a "willful default" or a "neglect of duty" makes the corporation liable. There are no cases in which any excuse for failure has been accepted by the courts. If the corporation does not collect the Corporate Loans Tax due to the Commonwealth from its creditors, for any reason whatsoever, the corporation itself is liable for this tax.

The third and most complex instance when a corporation is itself liable for the Corporate Loans Tax is when the liability arises under Section 19 of the Act of June 22, 1935, P.L. 414. This section states that,

"**Neglect or failure to give such notice before the first day of October of each and every subsequent year, during which such corporation is liable for the payment of such interest, shall make the corporation liable for such taxes for the year following without any deduction from interest due as hereinbefore provided:"

To clearly understand the meaning of the penalty provision of this section as it is set forth above, it is necessary to know the duty placed upon a corporation by

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8 Under these circumstances the corporation may deduct the amount of the tax paid from its income as a business expense.  
8 Commonwealth v. RR. 129 Pa. 429 at 449.  
6 n. 5.  
7 Com. v. WB and Scranton Railway, 162 Pa. 614.  
the preceding parts of this same section,⁹ for it is the breach of this duty that makes the corporation liable for the tax.

⁹ All scrip, bonds, certificates, and evidences of indebtedness issued, and all scrip, bonds, certificates, and evidences of indebtedness assumed, or on which interest shall be paid by any and every private corporation, incorporated or created under the laws of this Commonwealth or the laws of any other state or of the United States, and doing business in this Commonwealth, and all scrip, bonds, certificates, and evidences of indebtedness issued are hereby made taxable for the year one thousand nine hundred and thirty-six, and annually thereafter, for State purposes, at the rate of one mill on each dollar of the nominal value thereof, which tax shall be in addition to the tax imposed for State purposes by section seventeen of the act, approved the seventeenth day of June, one thousand nine hundred and thirteen (Pamphlet Laws, five hundred seven), and its amendments or supplements: Provided, That whenever, under the provisions of this section, any private corporation shall become liable for such taxes upon evidence of indebtedness by it assumed, or on which it shall pay interest, it shall be the duty of such corporation, not later than ten (10) days thereafter, to give notice in writing, to any person who may, at such time, be liable for the payment of any taxes upon such evidences of indebtedness, under the provisions of the third section of the act, that the corporation has assumed such indebtedness, or the payment of the interest thereon, and will deduct and pay the taxes imposed thereon, by this section. Such notice shall also be given before the first day of October of each and every subsequent year during which such corporation is liable for the payment of such interest. Where any private corporation shall assume such evidences of indebtedness, or the payment of interests thereon, prior to the first day of October in any year, and shall give notice, as hereinbefore provided, such corporation shall be relieved from duty of deducting and paying the taxes imposed by this section for the balance of such year; but shall deduct and pay said taxes for the ensuing year, and the person, to whom such notice shall be given, shall, for such ensuing year, be relieved from the payment of tax, under the provision of the third section of this act, upon such evidences of indebtedness so assumed, or on which the corporation shall pay interest. Where any private corporation shall assume such evidences of indebtedness or the payment of interest thereon, or on or subsequent to the first day of October in any year, and shall give the notice, as hereinbefore provided, such corporation shall be relieved from the duty of deducting and paying the tax upon such evidence of indebtedness by it assumed or on which it shall pay interest for the balance of such year and for the ensuing year, and the person, to whom notice is given shall pay the tax for the period for which the corporation is relieved upon such evidences of indebtedness so assumed, or on which the corporation shall pay interest, as provided for in the third section of this act. Neglect or failure on the part of any corporation upon assuming any evidences of indebtedness or becoming liable for the payment of interest thereon, to give the notice as herein provided and within the time prescribed, shall make such corporation liable for the payment of taxes from the time when such evidences of indebtedness are assumed, or for the entire period for which interest shall be paid. Neglect or failure to give such notice before the first day of October of each and every subsequent year, during which such corporation is liable for the payment of such interest, shall make the corporation liable for such taxes for the year following without any deducting from interest due as hereinbefore provided: Provided, That this section shall not apply to bank notes or notes discounted or negotiated by any bank or banking institution, savings institution or trust company, nor to interest bearing accounts in any bank, banking institution, savings institution or trust company: And provided further, That the provisions of this act shall not apply to building and loan associations or to savings institutions having no capital stock, and if at any time either now or hereafter, any persons, individuals, or bodies corporate have agreed or shall hereafter agree to issue his, their or its securities, bonds or other evidences of indebtedness, clear of and free from the said one mill tax herein provided for, or have agreed or shall hereafter agree to pay the same, nothing herein contained shall be so construed as to relieve or exempt him, it or them, from paying the said one mill tax on any of the said such securities, bonds, or other evidences of indebtedness, as may be held, or owing to, the said savings institution having no capital stock: And provided further, That the provisions of this act shall not apply to fire companies, firemen's relief associations, life or fire insurance corporations having no capital stock, secret or beneficial societies, labor unions and labor union relief associations, and all beneficial organizations paying sick or death benefits, or either or both, from funds received from voluntary contributions or assessments upon members of such associations, societies, or unions; And provided further, That corporations, limited partnerships, and joint stock associations, liable to tax on capital stock for state purposes, shall not be required to pay any further tax, under this section, on mortgages, bonds, and other securities owned by them in their own right; but corporations, limited partnerships, and joint stock associations holding such securities as trustees, executors, administrators, guardians, or...
When an obligation exists which is not subject to the Corporate Loans Tax and when that obligation becomes subject to the said tax by reason of the fact that the said obligation is assumed by a corporation which meets the requisites to make the obligation taxable; notice of the fact of taxability must be given to the taxable holder of the obligation by the assuming corporation within 10 days. Failure to do this makes the corporation itself liable for the tax. This liability of the corporation exists from the date the corporation assumes the obligation.

"It is the position of the Department of Revenue, therefore, that when a corporation fails to give notice within ten days of assuming an obligation which had been subject to personal property tax, that its duty is to deduct* and pay corporate loans taxes to the Commonwealth for the period beginning immediately upon its assumption of such obligation."\(^{10}\)

The length of time that this liability remains primarily upon the corporation depends upon when the corporation does give the required notice. If the notice is given prior to October first, in a subsequent year, then it would seem, by analogy to the situation of the original liability attaching,\(^{11}\) that the corporation itself would be liable for the tax for the balance of the year in which the notice was given. If the notice were given after October the first, by the same analogy, it would seem that the corporation would be liable for the tax for the year in which the notice was given and also for the following year.

It should be pointed out at this time that Section 19 of the Act of June 22, 1935 P.L. 414 requires that notice of the assumption of a taxable obligation by a corporation be given each year to the taxpayer by the corporation, and the failure of the corporation to do this would make it liable for the payment of the tax, at least for the years that such continuing notice as required by the act was not given; although it has been held that notice on the face of the obligation is sufficient to meet this continuing notice requirement of Section 19 of the act.\(^{12}\)

Finally, the corporation itself is liable for the Corporate Loans Tax when the corporation has issued obligations which are held by unascertained holders and when under such circumstances the corporation has not made a diligent search to locate these holders and thus determine the taxability of the obligation. In this event the corporation is liable for the Corporate Loans Tax upon the entire

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\(^{10}\) Dept. of Revenue Communication dated May 8, 1939. *This author is in agreement with the staff of Commerce Clearing House publications that the word deduct should not appear in this sentence. See Commerce Clearing House State Tax Reporter Pa. Vol. 1 p. 2668.

\(^{11}\) Sec. 19 Act of June 22, 1935 P.L. 414.


\(^{13}\) Com. v. Pa. Coal and Coke Corp. 39 Dauph. 102.
amount of the obligations held by the unascertained creditors; the balance of the corporate indebtedness being reported regularly and the tax being deducted from the taxable holder.

"The failure on the part of the controller to exercise due diligence makes the corporation liable for the loans tax on the unlocated indebtedness."\textsuperscript{13}

In addition to burden of proving due diligence is on the corporation,\textsuperscript{14} although meeting the burden is not difficult.

"The standard of diligence required of the treasurer of a Pennsylvania corporation in endeavoring to ascertain the names and residences of the owners of its indebtedness and whether the same were held in a manner to make them taxable, is not so high as to require him or the corporation to expend, in such effort, a sum of money equal to or greater than the amount of the commission which would probably be received by him for his services as agent of the Commonwealth in ascertaining, collecting, and paying over the tax upon such indebtedness."\textsuperscript{15}

When such diligent search is made as meets the requirements of the cases then the corporation is not liable for any of the unlocated indebtedness\textsuperscript{16} but it is only want of diligent search that makes them liable and then they are liable for the tax on the total unlocated amount.

In conclusion therefore, we may summarize the situations when a corporation is itself liable for the Corporate Loans Tax as follows:

1. When by agreement, contract, or the terms of the loan, they bind themselves to be so liable or they free the obligation from tax upon the purchasers of the obligation.

2. Upon the refusal, neglect, or failure of the corporation to perform its duty as collector of the tax from the individual taxpayer.

3. Failure of the corporation to give adequate and proper notice as required by Section 19 of the Act of June 22, 1935 P.L. 414 of their assumption of an obligation that becomes taxable under the act because of the corporations' assuming the obligation.

4. Failure to give continuing notice each year under the circumstances as set forth in 3 above.

5. Failure to exercise due diligence in ascertaining unlocated indebtedness in order to properly determine its taxability.

In these five instances the Pennsylvania Corporate Loans Tax is a tax upon the corporation.

\textsuperscript{14} n. 13.
\textsuperscript{15} Com. v. Safe Harbor Water Power Corp. 43 Dauph. 415.
\textsuperscript{16} Com. v. Safe Harbor Water Corp. supra.