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## **Public Utility Taxation in Pennsylvania: Article VIII, Section 4, of the Constitution of Pennsylvania 1968**

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PUBLIC UTILITY TAXATION IN PENNSYLVANIA:  
ARTICLE VIII, SECTION 4, OF THE  
CONSTITUTION OF PENNSYLVANIA 1968

SCOPE NOTE

On April 23, 1968, the voters of the Commonwealth of Pennsylvania approved proposal 5 of the Constitutional Convention of 1967-1968. Section 1C of proposal 5 is now section 4, article VIII of the constitution of Pennsylvania, 1968. Significant provisions of this section deal with the public utility tax exemption, gross receipts tax, and return of funds to local taxing authorities. The section requires the General Assembly to distribute among the local taxing authorities a proportion of the funds which those authorities could have raised individually by taxing the real property of public utilities. It states that the total amount of this fund shall be equal to the gross amount of real estate taxes which the authorities could have raised collectively by taxing utility realty. It further states, however, that gross receipts taxes imposed on utilities by the Commonwealth shall be in lieu of such local taxes.<sup>1</sup> These provisions are self-executing, effective July 1, 1970; unless the General Assembly passes prior enabling legislation.<sup>2</sup>

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1. PA. CONST. art. VIII, § 4 (1968):

Section 4. Public Utilities.—The real property of public utilities is subject to real estate taxes imposed by local taxing authorities. Payment to the Commonwealth of gross receipts taxes or other special taxes in replacement of gross receipts taxes by a public utility and the distribution by the Commonwealth to the local taxing authorities of the amount as herein provided shall, however, be in lieu of local taxes upon its real property which is used or useful in furnishing its public utility service. The amount raised annually by such gross receipts or other special taxes shall not be less than the gross amount of real estate taxes which the local taxing authorities could have imposed upon such real property but for the exemption herein provided. This gross amount shall be determined in the manner provided by law. An amount equivalent to such real estate taxes shall be distributed annually among all local taxing authorities in the proportion which the total tax receipts of each local taxing authority bear to the total tax receipts of all local taxing authorities, or in such other equitable proportions as may be provided by law.

Notwithstanding the provisions of this section, any law which presently subjects real property of public utilities to local real estate taxation by local taxing authorities shall remain in full force and effect.

Section 4. Sections 1 and 2 shall take effect as soon as possible, but no later than July 1, 1970. Section 4 shall take effect July 1, 1970, unless the General Assembly earlier provides enabling legislation in accordance therewith.

2. *Id.*

This Comment is intended as a comparison of utility taxation in Pennsylvania with taxation practices in the other states. It is also offered as an analysis of the content and implications of Section 4, Article VIII in light of its constitutional history and the development of Pennsylvania's unique judicially created tax exemption on utility property. It is hoped that the discussion will identify the need for, and possibly point the way to, a realistic solution to the utility taxation situation in Pennsylvania, a solution which will meet the needs of the Commonwealth and be in line with practice common in other states.

#### A. THE PUBLIC UTILITY PROPERTY EXEMPTION TO DATE

The property of a quasi-public service corporation which is ordinarily and properly pertinent and indispensably necessary to the proper operation of the works of the corporation, and to the enjoyment and exercise of the privileges and franchises granted to it by its charter, and not merely useful or convenient is not included within the meaning of the words "real estate" as used in the general tax laws, and hence is not subject to taxation for county, city, township, borough, road, poor, school, or other local purposes unless expressly made subject thereto.<sup>3</sup>

Using the above language the Supreme Court of Pennsylvania in 1825 created by judicial interpretation a tax exemption still in effect today.<sup>4</sup> The reason for the exemption, more understandable in 1826, was to protect and even to subsidize the fledgling public service corporations which were necessary to new and growing communities.<sup>5</sup> Since 1826, the courts have not hesitated to apply this exemption to railroad,<sup>6</sup> water,<sup>7</sup> gas,<sup>8</sup> power,<sup>9</sup> light,<sup>10</sup> and pipe-

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3. *Schuylkill Bridge Co. v. Frailey*, 13 S. & R. 422 (Pa. 1825). This case involved an attempt by the county of Philadelphia to tax the collector's house and other appurtenant realty of a privately owned toll bridge. The pertinent language conferring authority on the county to tax real estate was:

That the assessors . . . shall proceed to take an account of the following articles hereby made taxable, viz. all lands held by patent, warrant, location or improvement; houses and lots of ground and ground rents, all grist mills, sawmills . . . (mills and manufactories enumerated).

Act of April 11, 1799, § 8, 3 Sm. L. 392 (Pa. 1810).

4. *Coatesville Gas Co. v. County of Chester*, 97 Pa. 476 (1881).
5. *Schuylkill Bridge Co. v. Frailey*, 13 S. & R. 422 (Pa. 1825).
6. *Railroad v. Berks County*, 6 Pa. 70 (1847).
7. *Spring Brook Water Co. v. Kelley*, 17 Pa. Super. 347 (1901).
8. *West Chester Gas Co. v. County of Chester*, 30 Pa. 232 (1858).
9. *Conoy Township v. York Haven Elec. Power Plant Co.*, 222 Pa. 319, 71 A. 207 (1908).
10. *Id.*

line<sup>11</sup> companies.

The requirements which must be met to qualify for the exemption are that the owner of the property in question be considered a quasi-public service corporation, and that the property be "indispensably necessary" to the operation of the corporation in offering its service.<sup>12</sup> Railroad roadways, machine and repair shops, offices, depots, and car houses<sup>13</sup> as well as the realty, power plants and fixtures of electric companies;<sup>14</sup> the dams, reservoirs, conduits, and fixtures of water companies;<sup>15</sup> and the pipes, fixtures, and land from which gas is or may be taken by gas companies<sup>16</sup> have all been held to meet the two requirements.

Today, utility profits are generally assured by administrative rate fixing<sup>17</sup> and vast amounts of capital are no longer needed to establish and initially finance these now well-established corporations. The following discussion is intended to show that, as the original need and reasons for the exemption have diminished and ceased to exist, the exemption itself has become an anachronism serving the function of a tax loophole.

#### B. A SURVEY OF SIGNIFICANT PUBLIC UTILITY TAXES IN OTHER STATES

This section is intended as a guide for analyzing the utility tax situation in Pennsylvania and as a possible source of ideas for implementing legislation. It is a survey which is designed to give a general picture of the major revenue producing taxes paid by utilities in other states. The term "utilities" as used in this section generally includes electric, gas, water, pipeline, and railroad companies.

1. *Property taxes*—The term "property" as used in this and other sections of the Comment refers generally to the operating real property or that property used or useful in furnishing services. It may, however, in the case of some states, include nonoperating and personal property as well.

(a) *Railroad*—Because almost all states make special pro-

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11. Pittsburgh's Appeal 123 Pa. 37, 16 A. 621 (1888).

12. For an excellent and exhaustive study of the public utility tax exemption, see generally Exemption of Real Property of Public Utilities from Local Taxation in Pennsylvania, Walker W., 13 U. Prrt. L. Rev. 263 (1952).

13. Pittsburgh & L.E.R.R. v. Allegheny County, 283 Pa. 220, 128 A. 840 (1925); Railroad Co. v. Venango County, 183 Pa. 618, 38 A. 1088 (1898).

14. Conoy Township v. York Haven Elec. Power Plant Co., 222 Pa. 319, 71 A. 207 (1908); Southern Elec. L. & P. Co. v. Philadelphia, 191 Pa. 170, 43 A. 123 (1899).

15. Roaring Creek Water Co. v. Girton, 142 Pa. 92, 21 A. 780 (1891); Spring Brook Water Co. v. Kelley, 17 Pa. Super. 347 (1901).

16. Pittsburgh's Appeal, 123 Pa. 374, 16 A. 621 (1888); Coatesville Gas Co. v. County of Chester, 97 Pa. 476 (1881); West Chester Gas Co. v. County of Chester, 30 Pa. 232 (1858).

17. PA. STAT. ANN. tit. 66, § 1141 (1959).

visions for railroads, they will be considered separately. In Pennsylvania, railroads pay no tax on operating property. All other states, except Alaska, which exempts virtually all utility property and revenue from taxation,<sup>18</sup> fall into one of two categories. The first is comprised of those states which exempt railroad property from taxation in favor of some special tax. Only ten states fall within the group, generally substituting either a gross receipts tax or a special state assessment on property.<sup>19</sup> The second, by far the larger category, is made up of states which allow taxation of railroad property as part of the local property tax base. Thirty-eight states fall within the group.<sup>20</sup> In all of these thirty-eight states, assessment is by state agency with the rate generally equal to an aggregate of all lawful levies or as an average thereof.<sup>21</sup>

(b) *Other utilities*—With the exception, again, of Alaska<sup>22</sup> and Connecticut<sup>23</sup> and Minnesota<sup>24</sup> which provide partial exemptions, states fall into one of three categories based on the method of assessment. The first is composed of those states which provide for assessment by a state agency. Twenty-six states fall within

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18. ALASKA STAT. § 43.70.010 (1962).

19. CONN. GEN. STAT. ANN. §§ 12-256, 258 (1958); DEL. CODE ANN. tit. 30, § 3908 (1953); HAWAII REV. LAWS §§ 239-1 to 3 (1968); ME. REV. STAT. ANN. tit. 36, § 2623 (1964); MICH. COMP. LAWS § 450.305(b) (1967); MINN. STAT. ANN. § 295.02 (1962); N.H. REV. STAT. ANN. § 82:2 (1955); N.J. REV. STAT. § 54:29A-7 (Supp. 1968); VT. STAT. ANN. tit. 32, § 8211 (1959); WIS. STAT. § 76.01 (1957).

20. ALA. CODE tit. 51, § 142 (1958); ARIZ. REV. STAT. ANN. §§ 42-761 to 768 (Supp. 1969); ARK. STAT. ANN. § 84-601 (1947); CAL. CONST. art. XIII, § 14 (1966); COLO. REV. STAT. § 137-3-1 (1963); FLA. STAT. ANN. § 195.01 (1958); GA. CODE ANN. § 92-2608 (1961); IDAHO CODE §§ 63-113, 701 (Supp. 1969); ILL. ANN. STAT. ch. 120 § 499 (Smith-Hurd 1954); IND. ANN. STAT. § 64-1802 (1961); IOWA CODE ANN. § 428.24 (Supp. 1969); KAN. STAT. ANN. § 79-601 (1963); KY. REV. STAT. ANN. § 136.160 (1963); LA. REV. STAT. ANN. § 47:1979 (1950); MD. ANN. CODE art. 81, § 8 (1957); MASS. GEN. LAWS ANN. ch. 59, § 2 (1958); MISS. CODE ANN. § 9825 (1952); MO. CONST. art. X, § 5 (1965); MONT. REV. CODES ANN. tit. 84, §§ 427, 428 (1966); NEB. REV. STAT. § 77-601 (Supp. 1963); NEV. REV. STAT. § 361.320 (Supp. 1967); N.C. GEN. STAT. § 105-115 (1965); N.D. CONST. art. XI, § 179 (1965); N.M. STAT. ANN. § 72-6-5 (1961); N.Y. REAL PROP. TAX LAW § 102 (McKinney 1959); OHIO REV. CODE ANN. §§ 5727.12 (Baldwin 1968); OKLA. STAT. ANN. tit. 68, § 2442 (1966); ORE. REV. STAT. § 308.515 (1967); R.I. GEN. LAWS ANN. § 44-3-1 (Supp. 1968); S.C. CODE ANN. § 65-1521 (1962); S.D. CODE § 57.1603 (Supp. 1960); TENN. CODE ANN. § 67-901 (1956); TEX. REV. CIV. STAT. arts. 7145, 7159 (1960); UTAH CODE ANN. § 54-4-21 (1963); VA. CONST. art. XIII, § 176 (1956); WASH. REV. CODE § 84.12.200 (1962); W. VA. CODE ANN. ch. 11, art. 6, §§ 1-7 (1966); WYO. STAT. ANN. §§ 39-2, 246 (1959).

21. *Id.* Statutes cited note 20 *supra*.

22. ALASKA STAT. § 43.70.010 (1962).

23. CONN. GEN. STAT. ANN. § 12-258 (1965).

24. MINN. STAT. §§ 271.13-16 (1965).

this category.<sup>25</sup> Collection is generally at the local level on an apportionment from the state.<sup>26</sup> The second group is comprised of states providing for assessment by either the state or the local taxing authority. Ten states are included herein.<sup>27</sup> The decision as to who assesses is generally based on the type of utility or type of property involved.<sup>28</sup> The third and smallest group includes those states in which assessment is by the local taxing authority only. Seven states use this method.<sup>29</sup> It may certainly be said therefore that, unlike Pennsylvania, the vast majority of states do tax the property of public utilities.

*II. Gross Receipts and Income Taxes*—The term “gross receipts tax” as used in this Comment refers to any tax, the rate of which is expressed as a percentage of gross receipts. Such taxes are called franchise or license taxes in many states and are paid in addition to corporate income or privilege taxes. The term “income tax” refers to any tax, the rate of which is expressed as a percentage of adjusted net income regardless of name.

Excluding Pennsylvania, thirty-six states tax the gross receipts of public utilities.<sup>30</sup> Three of these—North Carolina, Okla-

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25. ALA. CODE tit. 51, § 142 (1958); ARK. STAT. ANN. § 84-601 (1947); CAL. CONST. art. XIII, § 14 (1966); COLO. REV. STAT. § 137-3-1 (1963); GA. CODE ANN. § 92-2608 (1961); ILL. ANN. STAT. ch. 120, § 499 (1954); IOWA CODE ANN. § 428.24 (Supp. 1969); KAN. STAT. ANN. § 79-704 (1963); KY. REV. STAT. ANN. § 136.160 (1963); LA. REV. STAT. ANN. § 47:1979 (1950); MD. ANN. CODE, art. 81, § 8 (1957); MISS. CODE ANN. § 9825 (1952); N.D. CONST. art. XI, § 179 (1965); N.M. STAT. ANN. § 72-6-5 (1961); N.Y. REAL PROP. TAX LAW § 102 (McKinney 1959); OKLA. STAT. ANN. tit. 68, §§ 2442, 2443 (1966); ORE. REV. STAT. § 308.515 (1967); S.C. CODE ANN. § 65-1694 (1962); S.D. CODE §§ 57.1801, 1902 (Supp. 1960); TENN. CODE ANN. § 67-901 (1956); UTAH CODE ANN. § 54-4-21 (1963); VA. CODE ANN. § 58-578 (1969); WASH. REV. CODE § 84.12.200 (1962); W. VA. CODE ANN. ch. 11, art. 6, §§ 1-7 (1966); WIS. STAT. § 76.01 (1957); WYO. STAT. ANN. §§ 39-2, 246 (1959).

26. Statutes cited note 25 *supra*.

27. ARIZ. REV. STAT. ANN. § 42-124 (Supp. 1969); IDAHO CODE ANN. §§ 63-113, 701 (1947); IND. ANN. STAT. § 64-401 (1961); MICH. CONST. art. IX, § 5 (1962); MINN. STAT. ANN. §§ 272.01, 273.35-37 (1969); MONT. REV. CODES ANN. tit. 84, §§ 901-905 (1966); NEB. REV. STAT. §§ 77-801 to 803 (Supp. 1963); NEV. REV. STAT. § 361.320 (Supp. 1967); N.C. GEN. STAT. § 105-355 (1965); TEX. REV. CIV. STAT. art. 7145 (1960).

28. Statutes cited note 27 *supra*.

29. FLA. STAT. ANN. § 193.11 (1958); ME. REV. STAT. ANN. tit. 36, § 2689 (1964); MASS. GEN. LAWS ANN. ch. 59, § 21 (1958); N.H. REV. STAT. ANN. § 82:37 (1955); N.J. REV. STAT. § 54:30A-52 (1937); R.I. GEN. LAWS ANN. §§ 44-3-1, 44-4-1 (Supp. 1968); VT. STAT. ANN. tit. 32, § 4042 (1959).

30. ALA. CODE tit. 51, § 117 (1958); ALASKA STAT. § 43.70.20 (1962); ARIZ. REV. STAT. ANN. §§ 42-1310, 1361, 1371 (1956); CAL. PUB. UTIL. CODE §§ 6001, 6231 (1965); COLO. REV. STAT. §§ 115-2-13, 14 (1963); CONN. GEN. STAT. ANN. §§ 12-251, 258, 265 (1958); DEL. CODE ANN. tit. 30, §§ 3301 3908, 4101, 4102 (1953); FLA. STAT. ANN. §§ 195.16, 203.01 (1958); HAWAII REV. LAWS §§ 126-1, 5 (1955); IDAHO CODE §§ 63-2071, 2701 (Supp. 1969); ILL. ANN. STAT. ch. 120, §§ 440-441 (Smith-Hurd 1968); IND. ANN. STAT. § 64-2601 (1961); LA. REV. STAT. ANN. § 47:1001 (1950); ME. REV. STAT. ANN. tit. 36, §§ 2623, 2624, 2683-2685 (1964); MD. ANN. CODE art. 81, § 130 (1957); MASS. GEN. LAWS ANN. ch. 63, § 52A (1969); MICH. COMP.

homa, and North Dakota—exempt railroads.<sup>31</sup> Six other states require that utilities pay a tax on their net income at rates ranging from 2 percent to 6.5 percent.<sup>32</sup> Of the thirty-four states levying a gross receipts tax, twenty-four set a rate of two percent or higher.<sup>33</sup>

In contrast, utilities in Pennsylvania pay a gross receipts tax of 22 mills per dollar of gross receipts,<sup>34</sup> and no property tax.

In summary, forty-eight states tax utility property.<sup>35</sup> Of these, forty-one also have a gross receipts or income tax.<sup>36</sup> Twenty-two of this number levy a gross receipts tax with an average rate in excess of 2 percent.<sup>37</sup> As to assessment for property taxes, twenty-seven states<sup>38</sup> assess all utility property at the state level and eleven others<sup>39</sup> provide at least for partial state assessment. It appears,

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LAWS § 450.304 (1967); MINN. STAT. ANN. §§ 295.01-43 (1962); MISS. CODE ANN. § 9825 (1952); MONT. REV. CODES ANN. §§ 84-1601, 2501, 2601 (1966); NEV. REV. STAT. §§ 704.690, 709.230 (1967); N.H. REV. STAT. ANN. § 83B:2 (1955); N.J. REV. STAT. §§ 54:30A-16 to 67 (1960); N.M. STAT. ANN. §§ 68-6-8, 69-7-22 (1961); N.Y. TAX LAW § 1105 (McKinney 1966); N.C. GEN. STAT. § 105-116 (1965); N.D. CENT. CODE §§ 57-39.01 to .02 (1960); OHIO REV. CODE ANN. §§ 5727.01-.37 (Baldwin 1968); OKLA. STAT. ANN. tit. 68, §§ 2601-2602 (1966); R.I. GEN. LAWS ANN. § 44-13-1 (Supp. 1968); S.C. CODE ANN. § 65-609 (1962); S.D. CODE §§ 57.4301-.4303 (1960); TEX. REV. CIV. STAT. arts. 7060½, 7067a, 7070a (1960); VA. CODE ANN. §§ 58-579, 580 (1969); WASH. REV. CODE § 82.16.010 (1962); WYO. STAT. ANN. § 39-291 (1959).

31. N.C. GEN. STAT. § 105-116 (1965); N.D. CENT. CODE § 57-39-01 to 02 (1967); OKLA. STAT. ANN. tit. 68, §§ 2601, 2602 (1966).

32. MO. REV. STAT. §§ 143.040, 070 (1959); ORE. REV. STAT. § 317.070 (1966); TENN. CODE ANN. § 67-2701 (1956); UTAH CODE ANN. § 59-13-3 (1953); VT. STAT. ANN. tit. 32, § 5831 (1961); WIS. STAT. § 71.01 (1965).

33. ARIZ. REV. STAT. ANN. §§ 42-1310, 1361, 1371 (1956); CAL. PUB. UTIL. CODE §§ 6001, 6231 (1965); CONN. GEN. STAT. ANN. §§ 12-251, 258, 265 (1958); DEL. CODE ANN. tit. 30, §§ 3301, 3908, 4101, 4102 (1953); HAWAII REV. LAWS §§ 126-1 to 5 (1955); ILL. ANN. STAT. ch. 120, §§ 440-441 (Smith-Hurd 1968); IND. ANN. STAT. § 64-2601 (1961); LA. REV. STAT. ANN. § 47:1001 (1950); ME. REV. STAT. ANN. tit. 36, §§ 2623, 2624, 2683-2685 (1964); MD. ANN. CODE art. 81, § 130 (1957); MASS. GEN. LAWS ANN. ch. 63, § 52A (1969); MINN. STAT. ANN. §§ 295.01-43 (1962); NEV. REV. STAT. §§ 704.690, 709.230 (1967); N.Y. TAX LAW § 1105 (McKinney 1966); N.C. GEN. STAT. § 105-116 (1965); N.D. CENT. CODE § 57-39.01 to .02 (1960); OHIO REV. CODE ANN. §§ 5727.01-.37 (Baldwin 1968); OKLA. STAT. ANN. tit. 68, §§ 2601-2602 (1966); R.I. GEN. LAWS ANN. § 44-13-1 (Supp. 1968); S.D. CODE §§ 57.4301-.4303 (1960); TEX. REV. CIV. STAT. arts. 7076½, 7067a, 7070a, (1960); VA. CODE ANN. §§ 58-579 to 580 (1969); WASH. REV. CODE § 82.16.010 (1962); WYO. STAT. ANN. § 39-291 (1959).

34. PA. STAT. ANN. tit. 72, §§ 2181-2183 (1949).

35. See statutes cited notes 20, 23-25, 27, 29 *supra*.

36. See statutes cited notes 30, 32 *supra*.

37. See statutes cited note 33 *supra*.

38. See statutes cited note 25 *supra*.

39. See statutes cited note 27 *supra*.

therefore, that not only in public utility taxation is Pennsylvania not in consonance with the practices of other states, but also that taxation of both utility gross receipts and realty at higher rates is common practice in other states.

#### C. HISTORICAL ANALYSIS OF THE CREATION OF ARTICLE VIII, SECTION 4

The Constitutional Convention convened on December 1, 1967. The question of public utility taxation was assigned by the Preparatory Committee to the Committee on State Taxation and Finance with the following official guidance:

If the continuation of the exemption for property of public utilities is desired, it may be advisable to strengthen the Constitutional basis for this exemption by adding a provision to Section 1 of Article IX authorizing the Legislature to exempt such property. If, on the other hand, the abolishment of the exemption for property of public utilities is desired, consideration should be given to adding to the Constitution (perhaps to Section 2) a clause providing that such property shall not be exempt from taxation.<sup>40</sup>

On January 24, 1968, the Taxation Subcommittee, to which the utility exemption question had been assigned, reported its proposal regarding the utility exemption question to the Committee on Taxation and Finance.<sup>41</sup> The proposal had passed the subcommittee by a 5-4 vote<sup>42</sup> and read as follows:

The General Assembly may, by general law, exempt from real estate taxes imposed by local taxing authorities the real property of public utilities which is predominantly used directly for the production, rendition, distribution, or delivery of public utility service, provided that any law establishing such exemption shall impose a uniform State real-estate tax upon said property, and shall provide for the distribution of the proceeds of said tax after the cost of collection to the local taxing authorities of the Commonwealth in a fair and equitable manner. The annual gross amount of said tax shall equal the gross amount of real estate taxes which said local taxing authorities would have collected upon said property in the preceding year but for said exemption, as determined by the General Assembly. Should the General Assembly fail so to exempt the said property from such taxes, said property shall be subject to real estate taxes imposed by local taxing authorities upon such property.<sup>43</sup>

The proposal recognized that utilities were subject to property taxes in other states, but that the imposition of such taxes by local authorities was not the most satisfactory method of adminis-

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40. REFERENCE MANUAL NO. 7, TAXATION AND STATE FINANCE, THE PENNSYLVANIA CONSTITUTIONAL CONVENTION 1967-1968, at 12.

41. REPORT OF MEETING, COMMITTEE ON TAXATION AND FINANCE, January 24, 1968, at 1.

42. REPORT OF MEETING, *supra* note 41, at 1.

43. *Id.* at 2.

tration. The stated purpose of the subcommittee's proposal was to establish a statewide, centrally administered property tax on public utilities, thereby creating a fund from which money would be returned to the local taxing authorities who had borne the burden of the utility exemption to date.<sup>44</sup> It further appears that the subcommittee had considered that such a measure would subject utilities to both the already existent gross receipts and the proposed property tax, and that the majority was not opposed to the idea.<sup>45</sup> The subcommittee minority, however, appears to have felt that a better method of returning funds to the local taxing authorities was through the use of the gross receipts tax alone.<sup>46</sup> To this end a substitute proposal was offered which read as follows:

Gross receipts taxes imposed by the Commonwealth on public utilities shall be in lieu of local taxes on the real property of public utilities used and useful in furnishing public utility services. The General Assembly shall provide for the distribution of a reasonable portion of such gross receipts taxes, not to exceed one-half the amount collected, among the local taxing authorities by an equitable method having due regard for the proportion which the real property tax receipts of each such taxing authority bears to the tax receipts of all such taxing authorities.<sup>47</sup>

The thinking behind this proposal appears again to have been a desire to see moneys returned to the local taxing authorities, although there was no apparent concern in returning an amount equal to that which the local taxing authorities could have raised by taxation of property. Rather a reasonable amount was specified.<sup>48</sup> There was a divided reaction by the full Committee on Taxation and Finance to the proposal and alternative proposals submitted by the Taxation Subcommittee. Part of the Committee on Taxation and Finance appears to have felt that implementation of the subcommittee's proposal would needlessly involve the state in real estate taxation when the same end, reimbursement to the local taxing authorities, could be accomplished more easily through the gross receipts tax.<sup>49</sup> Another view expressed was that the use of the gross receipts tax, as provided for in the alternative proposal, would actually be a tax on the Commonwealth. It would require the Commonwealth general fund to contribute a "reasonable amount" as reimbursement to the local taxing authorities

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44. *Id.*

45. *Id.* at 4.

46. *Id.* at 8.

47. *Id.*

48. *Id.*

49. *Id.* at 8-9.

without assuring any replacement to the state of funds so distributed.<sup>50</sup> The Committee on Taxation and Finance appears to have generally agreed to collecting additional funds from the public utilities to be returned to the local taxing authorities. The differences appear to have concerned the prospective source of the funds. Both the subcommittee proposal and its alternative proposals were referred back to the subcommittee pending final action by the full committee.<sup>51</sup>

On January 30, 1968, the Committee on Taxation and Finance gave final consideration to the public utility taxation issue. Three proposals were reported by the subcommittee. Proposals 1 and 2 were the original subcommittee proposal and alternate proposal, respectively. Proposal 3 read as follows:

The General Assembly shall impose a uniform State Real Estate Tax upon such property of public utilities which is predominantly used directly for the production, rendition, distribution or delivery of public utility services, and the General Assembly shall further provide for the distribution of such tax proceeds, after the cost of collection, to the local taxing authorities.

Should the General Assembly fail to provide for such tax within three (3) years from the effective date of this Article, the local taxing authorities shall place such real property on the regular tax assessment rolls.<sup>52</sup>

At this time, however, a majority of the committee seemed to favor the use of the gross receipts tax because they felt it would allow more simplified administration and not require creation and maintenance of a new administrative department. Such a method of collection would also avoid problems arising from local assessment and provide a more equitable distribution of funds to the local governments.<sup>53</sup> The minority in the full committee, however, still favored Proposal 1. A partial compromise was finally struck by substituting for the words, ". . . [R]easonable proportion of such gross receipts taxes, not to exceed one-half the amount collected, . . ." in Proposal 2 the following words: ". . . an amount equal to the gross amount of real estate taxes which the local taxing authorities would be authorized to impose."<sup>54</sup> This was to have been the amount which the state would have been authorized to collect by real estate tax under Proposal 1. The general feeling behind this compromise appears to have been that the new wording

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50. *Id.*

51. *Id.* at 8.

52. REPORT OF MEETING, COMMITTEE ON TAXATION AND FINANCE, January 30, 1968, 2:00 p.m. at 5. Tape recordings of this meeting as well as the other reports of committee meetings and proposals cited herein, may be found in BOXES 61, 63, 64, RECORD GROUP: CONSTITUTIONAL CONVENTION, PENNSYLVANIA STATE ARCHIVES, HARRISBURG, PENNSYLVANIA.

53. *Id.*

54. RECORDING OF MEETING, COMMITTEE ON TAXATION AND FINANCE, January 30, 1968, 2:00 p.m., side 2.

would prevent a failure on the part of the General Assembly to act to return sufficient receipts to the local taxing authorities.<sup>55</sup>

Several objections were voiced to this plan on the grounds that it would not of itself substantially change the present taxation situation.<sup>56</sup> However, it does not appear from the record that much discussion was given to the possibility that the General Assembly might not raise the gross receipts tax rate, enact other special taxes pursuant to the compromise proposal, or fail to enact enabling legislation prior to the date the proposal, if adopted, would take effect. Rather, the overwhelming thrust of opinions and concerns expressed in the committee meetings was directed toward the best method to be used to return to the local taxing authorities moneys which they had long been deprived, and to insure against a reduction in the gross receipts tax rate by the General Assembly.<sup>57</sup> After considering and agreeing on several other compromises concerning the amount to be returned to the local governments and the method to be employed to return it, the committee passed the compromise proposal by a vote of 22 to 5.<sup>58</sup> Following the work of the Style and Drafting Committee, the finished committee proposal was presented to the Constitutional Convention on February 1, 1968 as *State Taxation and Finance Committee Proposal, Section 1C*. It read as follows:

Public Utilities.—The real property of public utilities shall be subject to real estate taxes imposed by local taxing authorities. Gross receipts taxes imposed by the Commonwealth on said public utilities shall, however, be in lieu of local taxes on that real property which is used or useful in furnishing their public utility services. The General Assembly shall provide for the annual distribution among all local taxing authorities of an amount equal to the gross amount of real estate taxes which the local taxing authorities of the Commonwealth otherwise could have imposed upon said real estate in the preceding year. Such distribution shall be by an equitable method having due regard for the proportion which the tax receipts of each such taxing authority bears to the tax receipts of all such taxing authorities. That real property of public utilities which is not used or useful in furnishing their public utility services shall remain subject to local taxation.<sup>59</sup>

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55. RECORDING OF MEETING, *supra* note 54 at side 2.

56. RECORDING OF MEETING, *supra* note 54 at side 2.

57. REPORT OF MEETINGS, *supra* notes 41, 52; RECORDING OF MEETING, *supra* note 54.

58. REPORT OF MEETING, TAXATION AND FINANCE COMMITTEE, January 30, 1968, 7:45 P.M. at 2.

59. 34 JOURNAL OF THE CONSTITUTIONAL CONVENTION 428 (daily ed. February 1, 1968).

On February 28, 1968, the committee proposal in the form appearing below was adopted by the Convention by a vote of 137 to 8 and referred to the Committee on Arrangement, Submission and Address to the People.<sup>60</sup>

Section 3. Article eight of the Constitution of Pennsylvania is amended by adding after section 3, a new section, to read:

Section 4. Public Utilities.—The real property of public utilities is subject to real estate taxes imposed by local taxing authorities. Payment to the Commonwealth of gross receipts taxes or other special taxes in replacement of gross receipts taxes by a public utility and the distribution by the Commonwealth to the local taxing authorities of the amount as herein provided shall, however, be in lieu of local taxes upon its real property which is used or useful in furnishing its public utility service. The amount raised annually by such gross receipts or other special taxes shall not be less than the gross amount of real estate taxes which the local taxing authorities could have imposed upon such real property but for the exemption herein provided. This gross amount shall be determined in the manner provided by law. An amount equivalent to such real estate taxes shall be distributed annually among all local taxing authorities in the proportion which the total tax receipts of all local taxing authorities, or in such other equitable proportions as may be provided by law.

Notwithstanding the provisions of this section, any law which presently subjects real property of public utilities to local real estate taxation by local taxing authorities shall remain in full force and effect.

Section 4. Sections 1 and 2 shall take effect as soon as possible, but no later than July 1, 1970. Section 4 shall take effect July 1, 1970, unless the General Assembly earlier provides enabling legislation in accordance therewith.<sup>61</sup>

This, then, was the final form in which the proposal was submitted to the voters of Pennsylvania for ratification on April 23, 1968.

#### D. ANALYSIS OF THE PERTINENT PROVISIONS OF SECTION 4, ARTICLE VIII

As previously stated, the utility property exemption, prior to the passage of section 4, was strictly a child of judicial interpretation and, as such, could have been destroyed at any time by act

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60. 53 JOURNAL OF THE CONSTITUTIONAL CONVENTION 1338 (daily ed. February 28, 1968).

61. *Id.*

of the General Assembly.<sup>62</sup> The framers of section 4, however, created a situation unparalleled in the constitution of any other state.<sup>63</sup> By including these utility property taxation provisions in a constitutional document, the General Assembly has compounded the same problems it was trying to resolve. The net effect of section 4 is to restrict the courses of action open to the General Assembly by which the public utility tax system might be altered. This becomes apparent when the second sentence is read in conjunction with the first.<sup>64</sup> As long as the utility pays the gross receipts tax to the state, it has met the requirement of section 4. In other words, section 4 places a tax burden upon the Commonwealth itself without providing any reimbursement for the funds which will be allocated to the local taxing authorities.

The third sentence<sup>65</sup> incorporates the very difficulty to which the supporters of the alternative subcommittee proposal objected in the original subcommittee proposal—the difficulty in fixing the total amount of the fund to be returned due to variances in local assessment rates and practices.<sup>66</sup> As a standard for determining the total amount, this is a highly impractical one. The use of the word “exemption” in this sentence serves only to further foreclose the options of the General Assembly regarding utility taxation.

The second paragraph of section 4,<sup>67</sup> read in conjunction with the opening sentence of the first paragraph, appears to preclude the repeal of existing laws taxing utility realty. In fact, it does much more. Presently there are only two relatively minor statutory in-

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62. See PA. STAT. ANN. tit. 53, § 17032 (1957).

63. See LEGISLATIVE DRAFTING RESEARCH FUND OF COLUMBIA UNIVERSITY, INDEX DIGEST OF STATE CONSTITUTION (2d ed. 1959).

64. PA. CONST. art. VIII, § 4 (1968):

The real property of public utilities is subject to real estate taxes imposed by local taxing authorities. Payment to the Commonwealth of gross receipts taxes or other special taxes in replacement of gross receipts taxes by a public utility and the distribution to the local taxing authorities of the amount as herein provided shall, however, be in lieu of local taxes upon its real property which is used or useful in furnishing its public utility service.

65. PA. CONST. art. VIII, § 4 (1968):

The amount raised annually by such gross receipts or other special taxes shall not be less than the gross amount of real estate taxes which the local taxing authorities could have imposed upon such real property but for the exemption herein provided.

66. REPORT OF MEETING, COMMITTEE ON TAXATION AND FINANCE, January 24, 1968, at 8, 9.

67. PA. CONST. art. VIII, § 4 (1968):

Notwithstanding the provisions of this section any law which presently subjects real property of public utilities to local real estate taxation by local taxing authorities shall remain in full force and effect.

roads in the judicially created utility exemption.<sup>68</sup> Under these provisions and with the exception of water stations and road beds, operating property located in the cities of Philadelphia and Pittsburgh is subject to taxation.<sup>69</sup> Far more important, however, is the very distinct possibility that the machinery and equipment exclusion provision to the General County and Fourth and Eighth Class County Assessment Laws<sup>70</sup> which applies to industrial establishments will be held to apply to utilities, thereby excluding for taxation purposes:

Machinery, tools, appliances, and other equipment contained in any . . . manufactory or industrial establishment . . . as part of the real estate in determining the value of such . . . manufactory or industrial establishment.<sup>71</sup>

Such an interpretation would give the machinery and equipment exclusion constitutional rather than mere statutory status. Furthermore, the words "exemption as herein provided" in the third sentence which refers to the exemption from local taxes on public utility property "used or useful"<sup>72</sup> in furnishing its service appears to create an exemption broader than the judicially determined exemption which applied only to property "pertinent and indispensably necessary."<sup>73</sup>

For the reasons stated above it would appear that the utility exemption with all the definitional ambiguities over such terms as "real estate" and "used and useful," has actually been elevated from a judicial creation to a constitutional provision. Section 4 *has not* destroyed the public utility exemption; rather, it has codified it.

Ideally section 4 should never have become a constitutional provision. The wisdom of excluding detailed questions of taxation from such documents is well recognized:

Ideally a constitution should be silent on the subject of taxation and finance, thus permitting the Legislature and Governor freedom to develop special policies for the state to meet the requirements of their time.<sup>74</sup>

Now, however, Pennsylvania is faced with the difficult task of enacting enabling legislation prior to July 1, 1970 in order to raise additional funds to distribute to the local taxing authorities as mandated by section 4. It is the hope of this writer that as the preced-

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68. PA. STAT. ANN. tit. 53, § 17032 (1957); Act of January 4, 1859, No. 765, § 3, [1859] Pa. Laws 828.

69. PA. STAT. ANN. tit. 53, § 17032 (1957); Act of January 4, 1859, No. 765, § 3, [1859] Pa. Laws 828.

70. PA. STAT. ANN. tit. 72, §§ 5020-201, 5453-201 (1949).

71. *Id.*

72. PA. CONST. art. VIII, § 4, sent. 1, 3 (1968), quoted notes 64, 65 *supra*.

73. PA. CONST. art. VIII, § 4 (1968), quoted note 1 *supra*.

74. E. KRESKY, SALIENT ISSUES OF CONSTITUTIONAL REVISION 161 (1st ed. 1961).

ing sections have discussed and analyzed the problem as it exists presently, the following section will suggest a possible solution.

E. RECOMMENDATION OF ACTION THE GENERAL  
ASSEMBLY COULD PURSUE

For the reasons presented, it is the opinion of this writer that unless the General Assembly enacts appropriate enabling legislation prior to July 1, 1970, the utility exemption may well continue in effect in broader form as a constitutional provision. Furthermore, there will be an obligation upon the Commonwealth to repay to the local taxing authorities an amount as specified in section 4 with no provision for reimbursement to the general fund.

Based on the above survey, the type of legislation needed to bring Pennsylvania into line with the majority of other states, and to preclude the detrimental effects of permitting section 4 to self-execute, is enactment of a state property tax on utility property *in addition* to the present gross receipts tax. Assessment by state agency at a statewide average rate with apportionment by formula back to the local taxing authorities would avoid the inequities of tax windfalls to small communities and variances in local assessment practices feared by some of the drafters of section 4. Such sweeping legislation could also be the vehicle for abolition of the unnecessary distinction between real and personal property for tax purposes.

An alternative which would be less desirable but perhaps more politically practical would be an increase in the gross receipts tax or the enactment of a special tax upon public utilities as provided for in section 4. It should be provided, however, that the increased rate would in itself be sufficient to return revenues equal to those which could have been collected by a statewide property tax as described above and for the same reason. An equitable apportionment formula could then be employed to redistribute this fund to the local taxing authorities.

While the above recommendations are not the only possibilities, it is suggested that in considering the form which any enabling legislation should take, recognition should be given to the fact that other states tax utility operating property as well as their gross receipts and net income. Legislation which would ignore this fact and instead try to draw funds to return to the local taxing authorities from some source other than the utilities themselves would be both unreasonable and inequitable.

PHILIP R. MANN

## EPILOGUE

Subsequent to the completion of this paper, the General Assembly, in an attempt to comply with the provisions of article VIII, section 4, levied a tax upon the "state taxable value" of utility realty used in the furnishing of public utility services.<sup>75</sup> Section 3 of the Public Utility Realty Tax Act provides for a levy of 30 mills on each dollar of the "state taxable value" of utility realty. Section 1(D) states that such value is to be equal to ". . . the cost of the utility realty, less reserves for depreciation and depletion, as shown by the books of account of a public utility." The term "utility realty" as defined in section 1(C) does not include:

(I) easement or similar interests, (II) railroad rights-of-way and superstructures thereon, (III) machinery, equipment, poles, transmission towers, pipe, rail, or other lines, whether or not attached to . . . lands, buildings, towers, smokestacks or other structures, and (IV) such realty as is subject to local real estate taxation under any law in effect on April 23, 1968.<sup>76</sup>

Section 7 of the Act provides for the return of funds to the local taxing authorities based on a formula which allocates to each such taxing authority a share which will be equal to the ratio which the "real estate tax equivalent" of such authority bears to the total of all such "real estate tax equivalents." Section 2(F) defines the term "real estate tax equivalent" as ". . . the total amount of taxes which a local taxing authority could have imposed on *utility realty* but for this act" (emphasis added).

The Public Utility Realty Tax Act has in fact narrowed the definition of utility realty for taxation purposes and has in turn provided a broader machinery and equipment exclusion for public utilities. Such exclusions as are included in the General County and Fourth and Eighth Class County Assessment Laws apply to ". . . machinery . . . and . . . equipment contained in any manufactory or industrial establishment"<sup>77</sup> (emphasis added). Section 1(C) of the present Act, however, provides an exclusion for any machinery or equipment, including pipelines, *regardless of its location*;<sup>78</sup> and section 2(F) prohibits the local taxing authorities from considering any such machinery or equipment in determining their realty tax equivalents.<sup>79</sup>

The Public Utility Realty Tax Act embodies the basic require-

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75. Act of March 10, 1970, No. 66, [—] Pa. Laws —.

76. *Id.* § 3(C).

77. See note 70 *supra*.

78. Section 1(C) states that such machinery and equipment shall not be included in the definition of "utility realty" ". . . whether or not attached to . . . lands, buildings, towers, smokestacks or other structures."

79. Section 2(F) states that the "realty tax equivalent" is the amount ". . . which a local taxing authority could have imposed on *utility realty* but for this act" (emphasis added).

ments of article VIII, section 4. By so doing it will prevent section 4 from self-executing on July 1, 1970. By its terms, however, the Act levies a special tax within the meaning of article VIII, section 4, and not a true property tax on utility real property.<sup>80</sup> While it is apparent that the act has moved the Commonwealth a step closer to the final elimination of the anachronistic and inequitable utility property exemption, it is submitted that the narrow definition of the term "utility realty" and the specific enumeration of exclusions therefrom must be eliminated or severely modified before the property exemption will be truly dead.

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80. Nowhere in the language of the act is it stated that utility realty is subject to property taxation. Rather, the tax is levied on the "state taxable value." Furthermore, section 4 of the Act states that payment of the tax ". . . shall be in lieu of local taxes upon utility realty, as contemplated by article VIII, section 4 of the Constitution of Pennsylvania."