A SURVEY OF TAXATION IN TEXAS

Part IIA - Analysis of Individual Taxes Continued

Prepared by the

STAFF OF THE TEXAS LEGISLATIVE COUNCIL

Austin, Texas
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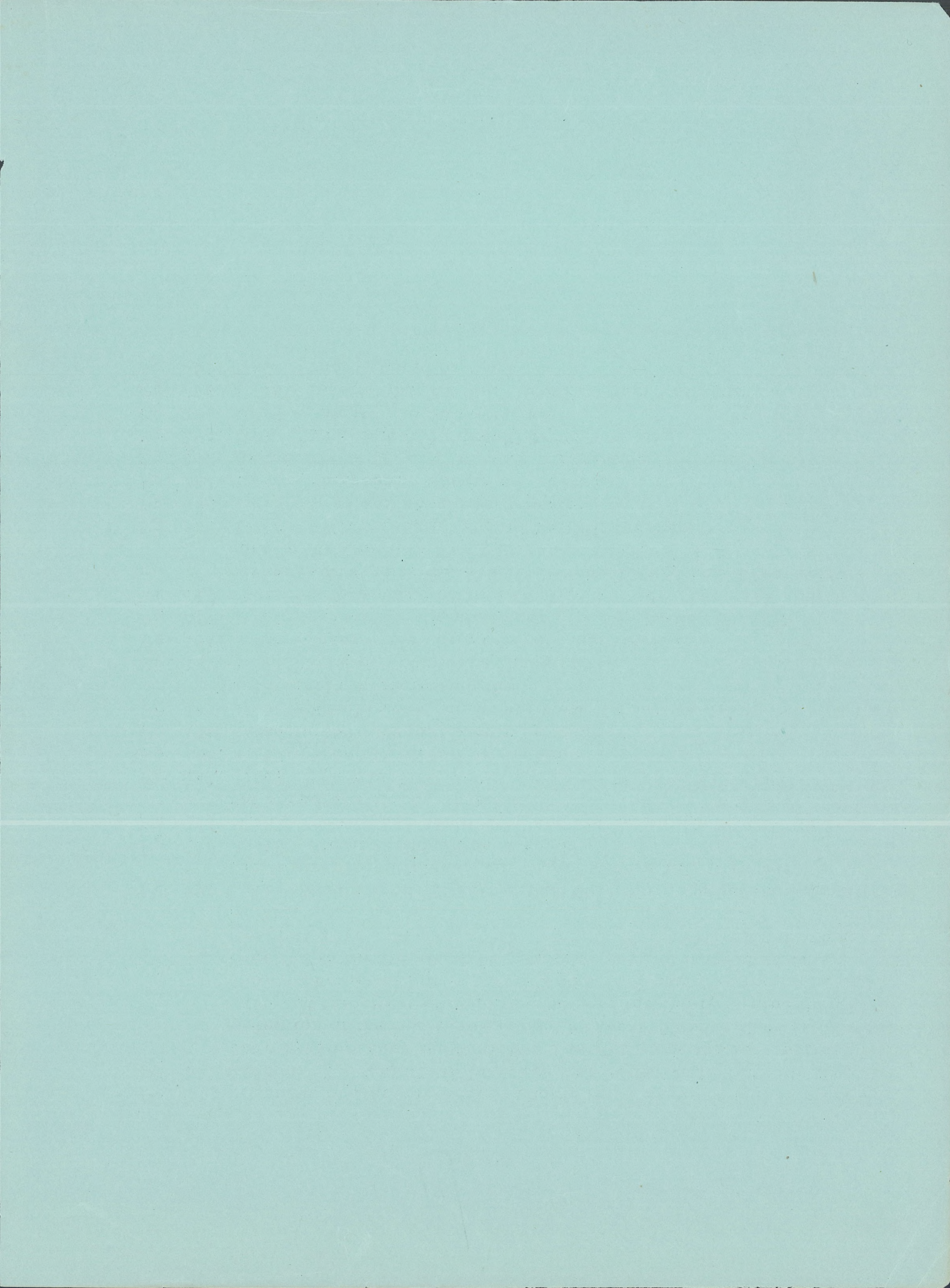
6806432

Errata

Pg. 314- "Census of Manufacturers" should be "Census of Manufactures"
Pg. 68, footnote 63 - Add "This increase was repealed in 1951 for the year 1951 because the Omnibus Tax Act made the rate permanent. Retention of the increase enacted by the 1950 special session would have had the effect of doubling the rate for the first nine months of 1951. The net result is that 3/4 of the 10 per cent increase will be credited to the Omnibus Tax Clearance Fund instead of to the Hospital Fund. See Acts 52d Leg., R. S., 1951, ch. 402, sec. 2, p. 712."
Pg. 99, l. 11 - Should read "It seems that the difference between annuity and life insurance policies is not as great as it might appear."
Pg. 109, l. 16 - "levied" should be "added"
Pg. 114, l. 12 - transpose "on death" and "of corporate stocks" to read "of corporate stocks on death"
Pg. 140, l. 29 - "(1.8 of $100,000)" should be "(1/8 of $100,000)"
Pg. 146, l. 37 - "remot" should be "remote"
Pg. 146, footnote 159 - "rule" should be "ruled"
Pg. 147, l. 27 - Should read "children; however, as the inclusion of the gift to the uncle in computing the"
Pg. 167, l. 7 - "inuqiry" should be "inquiry"
Pg. 191, l. 35 - Insert "his" between "of" and "business"
Pg. 217, l. 27 - Substitute "discontinued" for "also adopted"
Pg. 217 - Sentence beginning on line 28 should read "Thus, one-fourth of all revenues now go to the Available School Fund and three-fourths goes to the Omnibus Tax Clearance Fund."
Pg. 236, l. 12 - "Wichersham" should be "Wickersham"
Pg. 239, l. 15 - "reslae" should be "resale"
Pg. 241, l. 2 - "marshall" should be "marshal"
Pg. 242, footnote 55 - "Tex. Civ. App." should be "Tex. Crim. App."
Pg. 294, l. 9 - "$9 per gallon" should be "$9 per barrel"
Pg. 295, l. 19 - "most" should be "some"
Pg. 298, l. 18 - insert "that the tax" between "fact" and "is"
Pg. 303, l. 42 - "not" should be "now"



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(e) To sit and perform its duties in the interim between sessions;
(f) To report to the Legislature its recommendations from time to time and to accompany its reports with such drafts of legislation as it deems proper."

The object of this staff research report is to assist the Legislative Council in carrying out this responsibility. Any recommendations concerning the subject of this research report that the Council may make will be transmitted to the 53d Legislature.

TRANSMITTAL NOTE

This research report is submitted to provide background information and some general analyses of the assigned problem for the use of the Texas Legislative Council, its Study Committee on Taxation, and the Legislature of the State of Texas. This is a Staff Research Report for which only the staff assumes responsibility. The Council staff stands ready to assist the Council, the Study Committee, and the Legislature in any additional work on this subject.

The 52nd Legislature through H. C. R. 69 requested a study of the tax structure and a report to the 53rd Legislature. The Council at its first meeting directed its staff to proceed with such a study. Later, upon recommendation of the study committee, it agreed that the survey of individual taxes, already begun by the preceding Council, should be completed as a basic step to any other approach or study of the tax structure as a whole.

Two Staff Research Reports have preceded this report. They are _A Survey of Taxation in Texas: Part I - Comparative Tax Revenue Analysis -- Texas and Selected States;_ and _A Survey of Taxation in Texas: Part II - Analysis of Individual Taxes._ This report, _Part IIA, Analysis of Individual Taxes Contined,_ continues the series, and there is another volume, _Part IIB,_ to follow which will conclude the individual tax analysis.

This report is the result of the combined efforts of the Council staff. Arthur J. Pehrkon, Senior Staff Research Associate, was largely responsible for planning and supervising the research here presented. Before the completion of the study, Major Pehrkon was called into the armed services and Millard H. Ruud, Assistant Executive Director, assisted in the completion of the study. Other participants on various taxes were: Joe Grady Moore Jr., William C. Foster, Thomas I. Dickson, Phillip B. Goode, and Clarence C. Meyer. All made substantial contributions and some were responsible for an individual tax research.

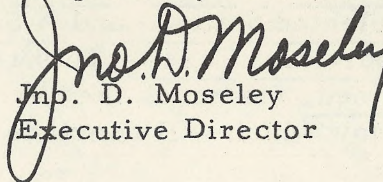
A more detailed description of the methods and limitations of the material presented in this report is set out in the Introduction. Briefly, this report contains an examination of the history and workings of the more significant state taxes from the revenue point of view. No attempt is made to determine who bears the burden of the taxes examined, what other taxes are imposed upon the persons affected by the individual tax, or the fairness of the tax rate.

In making this study, the staff consulted the laws of Texas and other states, the available technological and tax data, the reports of state agencies, and a great deal of other literature on the subject. Officials and employees of various state agencies, especially tax collecting agencies, were consulted.

The staff wishes to express its appreciation to the Comptroller of Public Accounts, the Texas Liquor Control Board, the Insurance Commission and their staffs and the various other state officials and employees consulted for their invaluable co-operation, information and help. This assistance greatly facilitated the preparation of this report.

This survey has emphasized to the staff the importance of a thorough study of taxation and the fact that this is only a part of such a long-range study. It is hoped, however, that this survey may be of assistance to the Legislative Council, its Study Committee on Taxation and the Legislature of the State of Texas.

Respectfully submitted,



Jno. D. Moseley
Executive Director

INTRODUCTION

Part IIA, Analysis of Individual Taxes, of the report on A Survey of Taxation in Texas has been prepared to present an analysis of some of the individual state taxes currently levied in Texas.

As mentioned in the Transmittal Note, the Legislative Council directed its staff to collect as much information as possible which would be useful to the Legislature in the field of taxation. The staff employed the working assumption that it was expected to do more than merely describe the tax law and the mechanics of its administration. In conformance with the procedure used in the other Staff Research Reports and approved by the Council, this report also describes the problems discovered or reported and the possible approaches to these problems which the staff found in its research and investigation. However, in view of the fact that this report involves a survey of the subject, these alternate approaches have not been fully investigated to determine their advantages and disadvantages and their validity and practicality. It was felt that if the Legislature, the Council, or any member became interested in any of the ideas reported, that then the staff would be available to do any further work that might be desired.

As a result of the limitations of time and those expressed in the instructions of the Council in the assignment of this topic, strict boundaries for the research carried out had to be established. No effort has been made to analyze the taxes from the viewpoint of the taxpayer. Analysis has been confined to the tax statutes, the records of and discussions with several tax administrators, and to printed and other written material available from library files and other sources. It is realized, of course, that a consideration of the viewpoints of interested taxpayer groups, and particularly of their knowledge of the trade and industry practices which bear on tax administration, would afford much valuable material. However, such consideration, even if it were done by sampling techniques, has been beyond the limits of time available for this survey.

The focus of the survey has been on the individual tax, with only incidental and occasional consideration of the relationship of each tax to the entire tax structure and to the other taxes now being levied. Thus, each chapter of this report is devoted to an individual tax and may be considered as complete within itself, not necessarily requiring reading within the context of the remainder of the report. In this way, it was felt that the report could serve as a convenient reference for those interested in one or another but not all of the taxes discussed.

It is obvious that any conclusions that might be drawn from material using such an approach cannot be generalized, nor applied to an area broader in scope than that under consideration. This point may be illustrated by an example. Note is made in the discussions of each tax whether it has a separate enforcement fund, or whether administrative costs are paid by the enforcement fund of another tax. The observation that a particular tax has its administrative costs paid by monies collected from another group of taxpayers may leave the impression that such practice is not preferred. No such evaluation is intended. Integration of enforcement funds may well be desired on the basis of consideration of all taxes or of groups of taxes. However, consideration of only one tax may indicate advantages of separate funds. On the other hand, the question could be raised whether or not it is good state tax policy to establish separate enforcement funds at all. Such apparent contradictions are not true conflicts of thought, but the result of different approaches to the same subject. The approach in this report has been narrow, confined to the particular individual tax under consideration.

As mentioned earlier each chapter of the report is devoted to one tax. The organization of the material within each chapter is the same. In each chapter the initial section devotes itself to the historical and legal background of the tax. The purpose of this section is two-fold. One is to permit the reader a brief orientation in regard to the environment in which the tax functions and in which it has developed. The other, to permit the reader a knowledge of the statutory changes which have preceded the current provisions of the law, and to indicate to a certain extent the effects on the current situation of earlier statutory provisions.

Following the initial section of each chapter are sections dealing specifically with the administrative organization which handles the tax, assessment methods and procedures, and collection and enforcement. The three sections discuss these phases of the administration of the present tax. Another section deals with the results of the operation of the tax from the point of view of revenues collected, comparability with similar taxes of other states, administrative costs, and the like. It is intended to afford the reader some basis for general comparisons which tend to be made between taxes, and to give some brief statistical data. It is realized, and it should be emphasized, that much of the comparative and statistical data available has only limited value for evaluative purposes of the taxes discussed. In fact, some of the data are not fully comparable. They are included primarily to afford a starting point for anyone interested in further study of these aspects of each particular tax.

Concluding the discussion of each tax is a section entitled "Summary and Problem Areas." In this are summarized those matters of policy or practice which appear to warrant consideration either because of the problems of tax administration or application which they occasion, or because other and different methods of dealing with them than those used in this state have been advocated or tried elsewhere.

In this section are presented the ideas mentioned earlier which have been found during the research and which can be used as possible approaches to each of the problem areas. None of these alternative methods is intended as a recommendation or proposal, but rather to point out some of the directions of approach which might be used. It has been assumed that an always-present possibility for the Legislature when considering these tax matters is the retention of the policy or method now being used. Therefore, no effort has been made to point out for each tax that continuance of the present plan is a possible method of dealing with the situation. This is intended to be obvious.

By means of this organization of the material presented, the report has endeavored to orient the reader, discuss the present administration and its relation to the tax statute, point out some of the significant areas about which questions of policy or practice may exist, and mention some of the alternative methods available for dealing with the problem areas. Such a method of presentation, of course, does cause some repetition but it facilitates reference to a particular kind of information.

The enormity and complexity of the subject matter has made it necessary throughout this report to summarize, delete and attempt to simplify matters which are difficult so to handle. It is recognized that there may be oversimplification in parts, misleading brevity in others, and occasional omissions. Because of this, it must be emphasized that this report is not to be considered as exhaustive of the subject matter dealt with, but rather as an initial survey of some of the taxes in Texas for the primary purpose of affording the Legislature as much information as possible to aid it in its work.

Contents

Chapter I: Radio, Cosmetics and Playing Cards Tax. . . 1

Chapter II: Gross Premiums Tax. 45

Chapter III: Inheritance Tax. 100

Chapter IV: Stock Transfer Tax. 175

Chapter V: Alcoholic Beverages Taxes 226

Chapter I

RADIO, COSMETICS AND PLAYING CARDS TAX

SECTION I - HISTORICAL AND LEGAL DEVELOPMENT

The heterogeneous bundle known as the radio, cosmetics and playing cards tax appeared on the statutes of Texas in 1941. Affecting three commodities having no apparent relationship, the tax could properly be considered as three separate levies. In application, the tax deals with three distinct groups of taxpayers, each group presenting problems of administration unique to itself.

However, the imposition of a tax on this oddly-assorted group of subjects in 1941 was not as puzzling as it may seem at first glance. Each of the three commodities is generally considered a "luxury," and there has been a long-established American habit to place excise or sales taxes on such items. Also, the tax fits within a pattern of development that is quite apparent in Texas tax history. Loosely described at times as the "creeping sales tax" trend, this development pattern has followed a fairly definite form in recent legislation. Consistently avoiding a general sales tax, Texas has availed itself of revenues from a growing group of selective sales taxes. By design or accident, the selection of taxed commodities has been generally restricted to those whose sales history across the nation has demonstrated considerable tax revenue potential, for example, cigarettes and automobiles. Too, the selection has generally been those commodities which have been the subjects of taxation in other states for some years.

By these criteria, imposition of the 1941 tax on the sale of radios and cosmetics cannot be considered surprising. The backgrounds of the industries involved provide an understanding not gained from examination of the tax law alone.

Rapid Growth of Radio Industry

From 1920, when the first radio broadcasting station in the United States was established, this industry mushroomed. Stations sprang up across the country, national networks were established, and a radio receiving set became a necessity in almost every American home. The popular interest evinced in the Pittsburgh, Pennsylvania, area as a result of the pioneer broadcasting efforts of station KDKA in the early 1920's made evident the possibilities for profit from the manufacture and sale of receiving equipment. These possibilities were quickly exploited, with a resultant boom in radio sales during the 1920's. By 1930, radio sets were significant items in the merchandising business of the country. In that year, more than 3,800,000 sets with a retail value of around $300 million were produced.[1]

[1] The World Almanac, 1951, p. 526.

Sales rose, although irregularly, even through the depression years. By 1941, the last year of full production before World War II, some 13 million sets with a retail value of about $460 million came off the production lines. During the war, the making of radio receiving sets for civilian buyers was discontinued, but radio, like many other products, had an immediate post-war boom, reaching a top production of 17 million sets at a retail value of $700 million in 1947. Production has dropped off since, and it is estimated that it will become reasonably stabilized at about six million home sets annually for the next few years. This, in terms of receivers produced, is about the 1935 level, but it should represent a substantially higher sale price.[2]

In this environment of booming sales and steadily increasing production, it was natural that the new industry should be looked upon as a favorable source of tax revenue. And, since the development of the industry coincided with the era of general sales tax adoption, the steadily increasing sales of radio sets were added to the other sources of such revenue.

Beginning in the 1920's, a few states began to adopt general sales taxes. During the early 1930's, this type of tax spread like wildfire across the country--14 states adopted a general sales tax in 1933 alone, and nine in 1935.[3] The federal government in 1932 enacted an excise tax on radio manufacturers.[4] In 1935, Alabama levied a tax on stores selling radio sets.[5] By 1941, there was a long experience background in many states concerning radio sets as a source of tax revenue.

It was not strange, in view of this background, that when the Texas Legislature looked to the selective sales tax as an additional source of revenue in 1941, radio sets were chosen as an item for taxation.

An Industry Built on Beauty

The background of the cosmetics industry also reveals a development which provides a clearer understanding of the Texas action of 1941 than is apparent from simply reading the law. Although cosmetics have been used by both men and women for many centuries, the cosmetics business in the United States prior to World War I probably never went above $24 million a year in value of product.[6]

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[2]Arthur W. Kramer, "Broadcasting," Encyclopaedia Britannica, Vol. IV, 1950 ed.; The World Almanac, 1951, p. 526; Radio-Television-Motion Pictures (Merrill Lynch, Pierce, Fenner, & Beane, 1951).

[3]State And Local Taxes in California: A Comparative Analysis, Part III, Senate Interim Committee on State and Local Taxation, April, 1951, p. 12.

[4]47 Stat. 263 (1932).

[5]General Acts of Alabama, 1935, p. 488, No. 194, H. 324, ch. I, sec. 348 schedule 117.

[6]Henry Tetlow, "Cosmetics," Encyclopaedia Britannica, Vol. VI, 1951 ed.

But with the close of World War I, a new era was born for the cosmetics industry. By 1919, production at the factory was valued at more than $80 million annually. Twelve years later, that figure had almost doubled.[7]

The industry fell off during the depression, but by 1939 it was again approaching its 1931 figure.[8] Unlike many others, cosmetics manufacturers continued quantity production during the war years. With the termination of hostilities, the post-war business boom accelerated cosmetics manufacture and sales. In 1947, cosmetics production, at factory prices, was valued at $425 million.[9] This, it can be recalled, compares with the $20-odd million of product value which characterized the industry just three decades earlier.

As in the case of radios, the rapidly expanding cosmetics industry quite early found itself being considered as a tax revenue source. During the 1930's, both Maryland and Ohio levied a ten per cent tax on retail cosmetic sales.[10] The rapid spread of general sales levies invariably included cosmetics among the taxable commodities. In 1941, the United States adopted a retail sales tax on cosmetics.[11]

Thus, as in the case of radios, when Texas considered adding another selective sales tax to its statutes in 1941, it is not difficult to see why cosmetics were chosen. An industry with a remarkable history of growth, with promise of continuing development, and demonstratedly a lucrative source of sales tax revenues, it was a logical selection. And, as with radios, cosmetics connoted in the public mind something of a luxury. Thus both of these sales taxes could be held to be, at least in part, luxury taxes.

From China to Canasta

However, the third portion of the tax bundle added to the Texas statutes in 1941 does not fall into the same pattern as the other two. The manufacture and sale of playing cards has never been considered a truly big business nor has it shown during any period of its development a rapid expansion such as that which characterized radio manufacture and cosmetics. History indicates that

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[7] Bureau of the Census, Census of Manufacturers, 1939.

[8] Ibid., 1947.

[9] Ibid.

[10] Tax Systems, 1934-1940; Commerce Clearing House, 1950 State Tax Guide.

[11] U. S. C., 1946 ed., tit. 26, sec. 2402.

playing cards were used in China before the 12th Century and were introduced into Europe around the 13th Century. In Europe, the making of playing cards became a respected and profitable art, and from there, the use of them spread throughout the civilized world.[12] Probably in view of the small size of the industry, it was not picked up by the Bureau of the Census, Census of Manufacturers, until 1947, in which year it was reported to have a production value, at factory prices, of over $15.5 million.[13] From federal revenue figures during the last 20 years, the industry would appear to be steadily but slowly expanding.[14] As in the case of cosmetics, manufacturers maintained production during the war years.

As a large revenue-raiser, or potentially large revenue-raiser, playing cards have never qualified. Nevertheless, two parallels with radio and cosmetics manufacture are evident. One is that a tax on cards would be considered by many people as a tax on a luxury; another is that playing cards, because of one motivation or another, have a considerable background of taxation in a number of jurisdictions. There is also, in the case of playing cards, a mild moral issue involved. Thus a tax on them may be considered by some as a deterrent to gambling.

The Republic of Texas taxed playing cards for about two years, from January 16, 1840, to February 5, 1842. The law imposed a tax at this rate: "On every pack of playing cards sold, given away, or otherwise disposed of, three dollars;. . ."[15] The State of Texas did not single them out for taxation until 1941.

General retail sales taxes, enacted largely during the 1930's, have usually included playing cards among the items taxed. Additionally, two states, South Carolina and Alabama, place stamp taxes on the sale of playing cards. In South Carolina, the tax is five cents on each 50 cents, or fractional part thereof, of the retail selling price. This tax dates back to 1928.[16] The Alabama levy on playing cards is one cent on each five cents, or fractional part thereof, of the retail selling price. It was adopted in 1935 when the State of Alabama, in need of money, passed a so-called license tax on the sales activities of a wide variety of businesses.[17] Both states also have a general sales tax, South Carolina's being three per cent and Alabama's two.[18]

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[12] Catherine P. Hargrave, A History of Playing Cards, (1930).

[13] Bureau of the Census, Census of Manufacturers, 1947.

[14] Tax Systems, 1934-1941; Annual Report of the Commissioner of Internal Revenue, 1941-1950.

[15] Gammel, Laws of Texas, vol. II, p. 190.

[16] South Carolina Laws, 1928, p. 1099.

[17] Alabama Laws, 1935, p. 485.

[18] CCH State Tax Guide, 1950.

The 1941 Tax Law

Enacted as part of the 1941 Omnibus Tax Law, the three-way radio, cosmetics, and playing cards tax was described as a luxury excise levy.[19] As finally passed, the act provided for a two-per-cent levy on gross receipts from the retail sale of new radios and new cosmetics and a flat rate levy of five cents per pack or deck on playing cards. Before passage of the tax bill, the Legislature had considered using a stamp tax for both cosmetics and playing cards, but the stamp provisions were not enacted.[20] The Comptroller was given the duty of collecting the tax and the necessary authority. Penalties were provided for failure to pay the tax or to make the required reports as well as for filing false reports and refusal to make reports upon notice by the Comptroller. A special enforcement fund of two per cent of the amount collected was provided.[21] The act became effective May 1, 1941.

The tax act had failed to define the terms "new," "cosmetics," and "playing cards". Accordingly, the same Legislature later added a section to the bill in which these deficiencies were remedied. This addition to the act became effective on May 31, 1941.[22]

As with all new taxes, application of the levies on the sales of radios, cosmetics, and playing cards brought a series of interpretations of the law. The development of the policy underlying application of this tax fell to the administrators and the Attorney General to a greater degree than in many other Texas taxes.

Among the policy determinations made, one of the first came about because of ambiguity in the meaning of gross receipts provided by the original law. In 1942, the Attorney General ruled that gross receipts should be interpreted to include the two-per-cent tax added to the regular price by the retailer -- if he indeed did add the tax to the sales price instead of absorbing it.[23] The difficulties of computation arising from this resulted in a legislative change of policy several years later. The 1950 amendment to the law, which added an additional ten per cent to the basic tax for a temporary period (March 1, 1950, to September 1, 1951), also redefined gross receipts. The

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19Acts 47th Leg., R.S. 1941, ch. 184, Art. X, sec. 1.

20Bills, 1941, 47th Leg., R. S., H. B. 1068.

21Acts, 47th Leg., R. S. 1941, ch. 184, Art. X, secs. 2-7.

22Ibid., ch. 394.

23Op. Tex. Atty. Gen. No. 0-4403 (March 14, 1942).

1950 act stated that such receipts would not "include the amount of tax. . . which the seller. . .receives above the regular price. . ."[24] Accordingly, the effect of the 1950 act was to allow the seller to pass the entire tax on to the consumer by adding it to the regular price.

No mention was made in the original law of installed radios sold with automobiles. By another opinion of the Attorney General, such sales were excluded from the purview of the radio sales tax provisions and were held to be subject only to the provisions of the motor vehicle sales tax (another section of the 1941 Omnibus Tax Law).[25] Thus, by interpretation, radios attached to automobiles at the time of sale were taxable at a lower rate than radios not so attached.[26] This has led to considerable controversy as a result of alleged evasions of the motor vehicle sales tax law.

Modern Magic -- Television

After World War II occurred another of the amazing series of industrial accomplishments which have characterized the American scene in the last half-century and particularly the last 25 years. This time it was television. Virtually unknown before 1945, except as a matter of occasional comment in newspapers and magazines, the television industry has risen phenomenally.

Experimentation with the sending of pictures on the airways had been going on before the last great war, but the process did not gain commercial status until afterward. Industry capitalized on the experience gained and the research done on a military project during war years. Probably no other newborn industry has ever traveled so far so fast. The rapidity of its development can be seen in the following table of TV receiving set production:

Total Production and Retail Value of Television Receiving Sets, 1947-1950

Year	Television Sets Produced	Retail Value
1947	210,000	$ 90,000,000
1948	1,050,000	360,000,000
1949	3,000,000	900,000,000
1950	6,500,000	$2,000,000,000

SOURCE: The World Almanac, 1951, p. 526.

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[24] Acts 51st Leg., C. S. 1950, ch. 2.

[25] Op. Tex. Atty. Gen. No. 0-3519 (May 25, 1941).

[26] See Texas Legislative Council, A Survey of Taxation in Texas -- Part II: Analysis of Individual Taxes, p. 69.

Although Texas has not shared in effects of the television boom to the same extent as Eastern and Midwestern areas because it is not yet connected with a national television system, it has nevertheless witnessed an amazing growth of the industry within the state. Accompanying this has been a large sale of television receiving sets.

In Texas there are presently six television sending stations in operation, which are located in Dallas, Fort Worth, Houston, and San Antonio. The national systems as of September, 1951, extend from coast to coast. They were formerly bounded on the west by Minneapolis, Omaha, Kansas City, Memphis and Birmingham.[27] When Texas is brought into a national chain, the television industry promises to undergo a sizable boom.

Unexpected as this sudden spread of television was to most people, the radio, cosmetics, and playing cards tax was quickly adjusted to the new situation by administrative ruling. After discussions with the Attorney General, the Comptroller issued a departmental regulation in 1948 which brought television sets within the scope of the tax law.[28] This received legislative approval in 1951 when a revision of the tax law enumerated new television sets as subjects of the tax.[29]

The 1951 change also made permanent at approximately the same levels the increased rates voted temporarily in 1950 and the procedural policy of considering gross receipts as not including the amount of tax paid by the consumer.[30] Thus the rates in 1951 were 2.2 per cent of the gross receipts on sales of radios and cosmetics and six cents per pack of cards.

In a ten-year period, this group of luxury excise taxes or selective sales taxes has apparently become an accepted part of the Texas tax structure. Yielding in 1950 almost one million dollars in revenue, taxes on the three items do not constitute a very large proportion of the total income of the state, but they do present interesting and significant potentialities.

From the taxation point of view, there are at least two important considerations concerning operation of the radio and television industries. The first is the possible influence of the spread of television on radio, and the second is the effect of war or preparedness activities on the civilian production of radio and television sets. It is generally conceded that development of television will have a damaging effect on radio listening. However, the wide sale of television sets would offset a reduction in radio sales and

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27 Texas Almanac, 1949-50, pp. 312-314; Radio-Television-Motion Pictures (Merrill Lynch, Pierce, Fenner, and Beane, 1950).

28 Letter of the Comptroller dated October 19, 1948, noted in Commerce Clearing House, State Tax Reporter (Texas) 32-205 (New Matters).

29 Senate Journal (Supplement) June 6, 1951, 52nd Leg. H.B. 285, sec.10.

30 Ibid.

could very well boost the tax yield from sale of receiving instruments. Since the great bulk of television sales are made to people in the lower income groups rather than, as some have surmised, to the wealthy, there is a wide area for sales expansion. There is no agreement on the saturation point for television, but it may well be over 75 per cent of the families in television areas.

The effect of war or extended military preparation on the production of radio and television sets for retail sale has to be taken into account. Both industries are vital to war production, and the materials they use are needed for national defense when the nation goes on a war-time status. Full-scale war would mean a drastic cut in tax income derived from retail sales of radio or television sets. Peacetime military preparations, depending on how extensive they are and how rapidly the power to produce is growing, could also reduce production for civilian use and consequently reduce tax income.

A Look Ahead

For the future, the levy on radio and television sales can perhaps look ahead to generally increasing revenues. A gradual shift of revenue sources from radio to television can probably be anticipated, but most merchandising sources indicate that the saturation point for radio receiving sets has not been reached. However, the FCC's slow-down in licensing new TV stations to unravel the interference problem and to settle issues regarding color TV may temporarily retard sales expansion. Current FCC plans anticipate about 1,500 or 1,600 TV stations[31] in the U. S. within five years and as many as 2,500 in ten years.

Under war conditions or in the event of a large-scale preparedness program, it is unlikely that this tax can be counted on to contribute much to the income of the state. Not only would the industry be absorbed in large part for military purposes, but credit regulations would probably limit sales.

In rather sharp contrast is the levy on cosmetics. An industry whose rapid and substantial development and growth show little indication of slowing down, it has demonstrated its capacity to maintain production and sales at a high level during war periods. Past experience with the cosmetics tax indicates that it can perhaps be counted on to provide a steady and growing, though relatively small, income to the state in future years.

As to the tax on playing cards, unless a popular fad gives unusual impetus to card sales in the future, there is considerable doubt whether tax revenues any greater than those of 1950 can be expected. The canasta fad apparently aided recent collections. Except for that, the revenue pattern of the card levy strongly indicates that it will have a slow increase hardly greater than the rate of population growth.

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[31] Lawrence P. Lassing, "The Electronic Era," Fortune, July, 1951, pp 79-82; Austin Statesman, July 19, 1951, p. B-2.

SECTION 2 - ORGANIZATIONAL FORM

The radio, cosmetics, and playing cards tax, called by the law creating it a "luxury excise tax," is, in effect, a special or selective sales tax. For radios and cosmetics, the tax is based on gross receipts from the retail sale of these items; it is a definite per cent thereof. Playing cards, on the other hand, are taxed at a flat rate per pack or deck.

Legal Provisions

The law places responsibility for administration of the tax on the Comptroller and gives him authority to "create such rules and regulations and require such reports" as he may consider necessary for efficient collection.[32] The only other official mentioned by the act is the Attorney General, and he is concerned only with the collection of delinquent taxes when court action is taken.

The act does not spell out the administrative organization or procedure to be used in its execution. Thus, the Comptroller, to whom the duty of collecting the tax is given, has considerable freedom in setting up the machinery through which the law operates. This is somewhat different from other tax laws, which prescribe in detail the duties to be performed and the agencies to perform them.

Actual Administration

The execution of the radio, cosmetics, and playing cards tax is, within the Comptroller's department, a function of two divisions. The Store Tax Division is charged with prime responsibility for its collection. However, this division has only a departmental administrative force and must rely for field work on the Cigarette Tax Division. In effect, one division handles the collection of the tax, the other most of the enforcement functions.

Even with this division of functions, the organizational form of the tax administration is relatively simple. It has the merit of utilizing existing facilities--i.e., a field force already trained and organized, operating in the same areas, and inspecting many of the retail outlets necessary to be contacted for the radio, cosmetics, and playing cards tax.

The arrangement is similar to that for the administration of the chain store tax. In practice, it suffers from one fundamental difficulty --divided control of administration. Although the head of the Store Tax Division is primarily responsible for the administration of the tax, he has to depend largely upon a field force not subject to his jurisdiction for enforcement of the law. Such an arrangement in and of itself, of course, cannot be criticized. Manifestly, separate field forces for every tax would not be feasible nor desirable. However, such an arrangement is fraught with difficulties. Even the most cordial and full co-operation between the two divisions involved does not permit a clear-cut delineation of responsibility and authority. It would be only natural to expect that the field agency would tend to concern itself primarily with the taxes for which it is directly responsible and to sandwich in the work involved with the radio, cosmetics, and playing

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[32] Acts 47th Leg., R.S. 1941, ch. 184, Art. X, sec. 2.

cards tax as time and available personnel permitted. Moreover, it is evident that co-ordination between the two divisions has been less than perfect. The Store Tax Division has been dealing directly with field personnel without any attempted co-ordination between the work assignments from the Austin offices of the two divisions. Accordingly, common policies have not always been followed, and field itineraries have at times had to be repeated unnecessarily.

Administrators of the two divisions have recognized this problem. Plans to better co-ordinate the activities of the two agencies are at present being considered. By September 1, 1951, all field work assignments were to have been channeled through the head of the Cigarette Tax Division. Such an arrangement should result in better control of field operations, making it possible to utilize personnel more fully and to better plan enforcement programs. It will only partially achieve centralization of enforcement policy, however, and will still require that division heads co-ordinate their plans closely and reach policy decisions together.

At present, the fact that the central offices of the two divisions lack knowledge of the actual workload in the field and of the time required for the processing of radio, cosmetics, and playing cards tax claims in the field precludes any thorough co-ordination.

In view of the existing situation in the Austin offices, whatever policy is being made with reference to field enforcement and collection must come from the districts. Central control over field activities is not in evidence. Under such conditions, it is difficult to develop uniform policies and practices in accordance with requirements of the over-all tax situation. The fact that field enforcement of the radio-cosmetics-cards tax is dependent more upon the field schedules set up to fulfill other work demands than upon the delinquency situation of the radio-cosmetics-cards tax is indicated by a survey of 1950 field activity in relation to this tax. Planned follow-up of delinquency in regard to the radio and cosmetics tax is not evident, although many regular field collections are made, evidently in conjunction with contacts made for enforcing other taxes. In this regard, it is interesting to note that the State Auditor in 1945 recommended that the Store Tax Division and the Cigarette Tax Division be combined.[33]

[33] Audit Report of State Comptroller of Public Accounts, State Auditor, August 31, 1945, p. 63.

SECTION 3 - ASSESSMENT METHODS AND PROCEDURES

The radio, cosmetics, and playing cards tax depends on a self-assessment procedure. Retailers of these articles are required to make quarterly reports to the Comptroller in which they state gross receipts from the sale of new radios and cosmetics and the number of decks of playing cards they have sold. On these report forms, the taxpayer computes his own tax, and payment is submitted along with the report.

The current rates, as a result of the 1951 changes in the law, are 2.2 per cent on gross receipts from the retail sale of radios and cosmetics, and six cents per deck of playing cards.

Definitions of what is meant by the terms "cosmetics" and "playing cards" are written into the tax statute to clarify the classifications intended to be taxed. Radios, however, are not defined. In the case of cosmetics, the 1941 revised act reads as follows:

> The term "cosmetics" as used in this Article means: rouge (liquid, semi-solid, or solid), lipstick (liquid, semi-solid or solid), face powder, face creams (including cleansing, foundation, vanishing massage or any other similar cream to be used on the skin), lotions (hand, face and skin, including astringents), nail polish (all kinds) and manicuring preparations, eyelash preparations, eyebrow pencils, eye shadowing preparations, hair oil, hair tonic and other hair preparations; but such shall not include soap (liquid, semi-solid or solid) nor any prescription prescribed for a particular individual by a physician regularly licensed and practicing in the State of Texas when such prescription is filed with and filled by a pharmacist.[34]

Since it is obvious that the term "cosmetics" presents a rather sizable problem of definition, the Legislature resorted to the method of enumeration.

In defining playing cards, the Legislature went almost to the physical limits of exactitude. As a result, there has apparently been no need for interpretations of this definition. The amended act of 1941 defines "playing

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[34] Acts 47th Leg., R.S. 1941, ch. 394.

cards" in the following manner:

> The term "playing cards" is defined to be a deck or pack containing at least fifty-two (52) cards of four (4) suits, commonly known as spades, hearts, diamonds, and clubs, and each such suit containing an ace, king, queen, jack, ten, nine, eight, seven, six, five, four, three, and deuce, such deck sometimes including a fifty-third or extra card, commonly known as the joker.[35]

Quite apparently, pinochle decks and cards with other than the conventional design, such as those used for Rook, Old Maid, and the like, are not within the purview of the levy.

Interpretations Required Early

As mentioned in Section 1, problems of definition arose immediately after the 1941 enactment of this statute. In the years following, most of the problems have been solved through the media of Attorney General's opinions and administrative rulings. As a consequence, these now make up a considerable body of regulations which supplement the statute and have, in practice, the same effect as the law. Court interpretations of the law and legislative revision have here played a very minor role in developing the policy of this law, although they have been important in other tax statutes.

The classifications on which the tax is applied read simply in the statute. However, soon after enactment of the tax it was apparent that the radio, cosmetics, and playing cards tax in operation was faced with some real problems as to what was to be taxed and what was not to be.

One of the first of these problems arose in regard to determination of which sales of radios, cosmetics, and playing cards were subject to the tax. It will be recalled that the taxes were specifically levied on "new" radios and cosmetics, although the adjective was not used in regard to playing cards. Thus, presumably, a retail sale of old or used playing cards would be taxable.

The 47th Legislature did not at first define the word "new", but the same Legislature later amended the act to provide this and other definitions. Section 1a states:

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[35] Ibid.

> The term "new" as used in this Article in connection with the terms "radios" and "cosmetics" shall mean those cosmetics or radios not theretofore sold at retail to the consumer.[36]

The Attorney General, in a ruling specifically dealing with cosmetics, declared that the distinction to be made is that between new on the one hand and used or second-hand on the other.[37] Whereas this is what one normally expects when speaking of new articles, the Attorney General's ruling is not superfluous. This exact problem could come up in connection with the resale of items by beauty shops after the tax has already been paid by the wholesaler. Under the Attorney General's interpretation, such a resale would still be retail sale of a new product and therefore taxable.

Exemptions

In addition, several other questions arose. One was the problem of radios sold with automobiles. A motor vehicle sales tax law was passed by the Legislature at the same time (1941) as the radio, cosmetics and playing cards tax law. Administered by the Ad Valorem Division of the Comptroller's office, the motor vehicle sales tax is collected through county tax assessor-collectors. Since a substantial number of radios are sold installed in cars, the administrative difficulties of co-ordinating activities of three divisions became quickly apparent when the two tax laws were put into operation. The problem was settled by an opinion of the Attorney General soon after passage of the tax law.[38] He ruled that a car radio, if attached to the vehicle at the time of sale, is exempt from the radio tax, but its value must be considered as part of the sales price under the motor vehicle sales tax.[39] In effect, this ruling simplified the administrative process but created serious doubts in the minds of many administrators as to whether tax coverage was complete in regard to radios. Since the affidavit forms used for the motor vehicle sales tax do not require that cost of radios be shown separately, there is no way at present to determine whether full tax coverage of car radios is being effected. Additionally, the opinion exempting car radios from the radio tax reduced the tax on such radios, since the motor vehicle sales levy is substantially lower than that specified by the radio, cosmetics, and playing cards tax.[40]

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[36]Ibid.

[37]Op. Tex. Atty. Gen. No. 0-3496 (May 16, 1941).

[38]Op. Tex. Atty. Gen. No. 0-3519 (May 23, 1941).

[39]See discussion in Texas Legislative Council, A Survey of Taxation in Texas -- Part II; Analysis of Individual Taxes, Staff Research Report No. 51-8, March, 1951, p. 69.

[40]Acts 52nd Leg., R.S. 1951, ch. 402, sec. VII.

Another problem appeared early in the history of the tax concerning radio "combinations," such as radio-phonograph sets and the like. These combinations are among the most costly products of the radio and television industries, and as such are significant from a tax viewpoint. According to the Comptroller in his instructions to retailers, the entire proceeds from a combination set sale are to be used to compute the tax.[41] However, an opinion of the Attorney General on the same subject is not so emphatic. He declared that when combination sets, such as radio-phonograph, radio-phono-record changer, or radio-phono-record changer-recorder sets are sold as a unit and the price is not broken down to separate that of the radio, the tax should be paid on the price of the entire combination.[42] Presumably, if the price is broken down to segregate cost of the radio, the tax would accrue only on that part of the sales price. The Comptroller's instructions to retailers go on to state that "record players are not radios /and therefore not liable for the tax/ when sold separately." The result of the Attorney General's interpretation is that part of the sales price of a radio-phonograph combination is exempt under certain conditions, but the Comptroller's published instruction sheet to the retailers does not indicate this exemption possibility.

If dealers do not separate value of the radio in the sale price of combinations, this matter is of little importance. As far as is known by administrators, no such separation of price components is practiced at present. However, since some of the payers of the radio tax have an annual radio sales volume in excess of three million dollars, they may conclude that the tax savings are sufficient to make it profitable for them to inaugurate the practice of quoting sales price by components in the case of combinations, e. g. sale prices of cabinet, record player, radio, and total price. Such an eventuality could make a substantial difference in the amount of tax collected. However, it may not be psychologically sound sales practice. Interpretation of the law has added other exemptions not expressly stated in the statute. The Attorney General has ruled that radios shipped into the state to local consumers are exempt from the tax, even though the orders were taken by salesmen operating within the state.[43] In other words, the customer can place his order with a salesman who will have the radio shipped direct from a point outside of the state, and the transaction will not come within the scope of the radio sales tax. Moreover, the Attorney General has decided that a foreign corporation selling cosmetics in the state through local sales representatives, where orders are subject to acceptance by the home office, is engaged in interstate commerce and therefore not subject to the tax. This applies even though the merchandise is sent to the local representative for ultimate delivery to the consumer.[44] For

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41Comptroller of Public Accounts, undated,"Notice to All Retail Dealers Selling New Radios, Cosmetics and Playing Cards."

42Op. Tex. Atty. Gen. No. 0-4014 (October 1, 1941).

43Op. Tex. Atty. Gen. No. 0-4725 (February 18, 1942).

44Atty. Gen. Opinion, 0-6255 (January 15, 1951).

example, a door-to-door cosmetics salesman can receive an order from a housewife for two jars of cold cream and forward that order to the out-of-state manufacturer. The cold cream can then be sent back to the salesman, who takes the package, delivers it to the housewife, and collects the money. Such a transaction is not taxable under the law. Use clauses in some tax laws permit coverage of such sales, but no such provision is contained in the radio, cosmetics, and playing cards tax.

Persons who wish to speak before a visible audience and those who like to tinker are not taxed by the state of Texas through its levy on radios. The Comptroller has ruled that radio tuners, public address amplifiers, and television or radio "make-your-own" kits are not subject to the radio sales tax.[45]

Thus, though exemptions are not specifically spelled out in the tax statute, several exist in actual practice as the result of administrative rulings and opinions of the Attorney General. Development of this tax by administrative rulings on policy has been quite extensive, however, only a relatively small part of this development has been on the matter of exemptions.

What Is a Retail Sale?

One of the stumbling blocks to easy administration of the tax which still persists to some extent is the matter of determining retail sales. The statute defines retail sales simply and succinctly but so briefly that clarifying interpretations have been necessary on several occasions. According to the law, "a retail sale. . .means a sale to one who buys for use or consumption, and not for resale." Nothing further is said on the matter.

Several interpretations have been made with reference to sales by wholesalers. The general ruling has been that sales, even if made by wholesalers in wholesale lots, are taxable as retail sales if they are made to someone buying for use or consumption rather than for resale.[46] Accordingly, if a wholesale dealer in radios should sell several radios to an organization for use in its clubrooms, he would be liable for tax on the sales price.

Following this general principle, the Comptroller has instructed wholesale distributors selling cosmetics to beauty and barber shops to pay the tax on such sales. If, however, the beauty or barber shop resells the item, it must pay a tax covering the difference between the price paid the wholesaler and that paid by the customer. This ruling was made to cover small barber and

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[45] Letter of the Comptroller dated December 9, 1948, noted in Commerce Clearing House, Texas State Reporter, 32-205.

[46] Comptroller of Public Accounts, undated, "Notice to All Retail Dealers Selling Radios, Cosmetics, and Playing Cards."

beauty shops which make only occasional retail sales and do not keep regular stock for that purpose. If the shop is regularly in the business of retailing cosmetics, it must handle the tax.

Thus the actual disposition of the article, rather than the intention of the purchaser, has been held to determine liability, although the law defines a retail sale as "a sale to one who buys for use or consumption."

To make clear the inclusiveness of the tax, the Comptroller has seen fit to place in his instructions a specific statement that door-to-door sales of items mentioned in the act are subject to the tax and that salesmen must make the required report. Accordingly, a peddler selling cosmetics must adhere to the provisions of the act just as a person who operates a drug store.

The Attorney General has ruled that non-profit marketing associations selling items mentioned in the radio, cosmetics, and playing cards tax act must pay the tax.[47]

Although generally states do not tax the federal government, the Attorney General has decided that retail sales of radios, cosmetics, or playing cards to the federal government come within the scope of the tax. He declared that the levy is on the retailer, not the purchaser, and for that reason, there is no question of the state taxing the federal government.[48] Legally, then, the radio, cosmetics, and playing cards tax is laid on the retailer regardless of who actually pays it.

The Meaning of Gross Receipts

Another matter which has been a problem in the administration of the radio, cosmetics, and playing cards tax is the concept of gross receipts. As has been noted, the amount of tax on radios and cosmetics is computed on the basis of such receipts. For playing cards, the situation is different, and all the retailer has to do is to count the number of decks sold and pay six cents on each. For radios and cosmetics, however, he has to make an account of the money he received from retail sales of these items and compute the tax at 2.2 per cent of that amount.

As discussed in Section 1, the term "gross receipts" has undergone a legal change since the 1941 act was passed. The current law reads:

> Gross receipts of a sale means the sum which the purchaser pays, or agrees to pay for an article or commodity bought at retail sale, but does not include the amount of tax provided by this section, which the seller charges and receives above the regular price of an article or commodity.[49]

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[47] Op. Tex. Atty. Gen. No. V-718 (November 17, 1948).
[48] Op. Tex. Atty. Gen. No. O-5260 (May 7, 1943)
[49] Senate Journal (Supplement) June 6, 1951, 52nd Leg., H. B. 285, sec. 10.

There have been several other rulings relating to what is to be included in the gross receipts on which the retailer pays radio and cosmetics sales taxes. The Attorney General has decided that the federal retail tax on cosmetics is not a part of the sale price and is not, therefore, to be counted in determining gross receipts.[50] At the same time the Attorney General decided the federal cosmetics tax was not to be counted as part of gross receipts, he ruled that the federal manufacturer's radio tax was to be counted.[51] This, he said, was a different situation. The federal radio tax was paid by the man who made the radio, and from that time on it became part of the price rather than something to be considered separately. Accordingly, a retailer buying a radio at wholesale for $110 and reselling it at $160 could not deduct from the amount reported for tax purposes the $10 of the wholesale price which was added to cover the ten per cent federal radio manufacturer's excise tax.

A radio sale is not necessarily a simple matter of handing money across the counter in one direction and the radio across in the other. Accordingly, an Attorney General's ruling, requested by the Comptroller, ruled that when a new radio is sold and part of the payment for it takes the form of a trade-in, gross receipts tax must be figured on the retail selling price of the new radio, including any allowance for the old one. Carrying and installation charges, however, are not included.[52] In a hypothetical case, a radio salesman sells a radio for $100. As part of the payment, he allows $15 on an old radio traded in. Then he charges the buyer $5 for installing the radio. In addition, this radio is bought on credit and the buyer pays, over a period of one year, an additional $10 in interest. In this example, the tax would be collected on $100, or, stating it another way, the dealer would be supposed to report $100 as his gross receipts from the sale.

While these distinctions look precise as rulings, their clarity is not evident in practice. Many dealers do not maintain the complicated records which would provide all this information. Records may not be kept of installation costs. Trade-in amounts might or might not be recorded. As a result, dealers frequently rely on estimates to compute the tax.

Although the statute sounds as if assessment of gross receipts ought to be simply a matter of counting up the cost of all the covered items sold at retail, the determination is more complicated in practice. Some retailers have simplified the process by merely applying their standard mark-up to the amounts on invoices from wholesalers. This tends to give the state an advantage because it does not allow for breakage, mark-downs for sales, or other such incidents. The dealer, on the other hand, receives the benefit of much greater simplicity in his accounts. Also, when a case of delinquency

[50] Op. Tex. Atty. Gen. No. 0-4506 (November 7, 1941).

[51] Ibid.

[52] Op. Tex. Atty. Gen. No. 0-3681 (June 17, 1941).

arises in the payment of the cosmetics tax and the dealer has no adequate records on which the amount due can be computed, the adopted practice has been to use the record of receipts from the federal toilet articles tax as a basis on which an assessment can be made. Since the federal toilet articles tax covers a wider number of items than the Texas cosmetics tax, this leads to overvaluation and penalizes the retailer who fails to keep proper records for state tax purposes. These two modifications are good examples of methods adopted to bring about the essential intent of the law but which go at it in a somewhat different manner than the law seems to indicate. It also points up the problem of having records from which the tax can be figured. Many dealers do not in fact keep such records, and much of the assessment, whether made by the dealer or by the collector, of necessity consists of guesswork.

Radio and Television Sets Defined

Although the Legislature felt compelled to add a section defining two of the articles to be taxed -- cosmetics and playing cards -- it has not so clarified what is meant by radios and television sets. Probably the Legislature felt that these articles were sufficiently recognizable. Moreover, defining them would be extremely difficult and of a highly technical nature, and this could give rise to a series of fine points to plague the collector.

As might be expected, points requiring clarification have arisen and, since the radio and television tax supplies the largest portion of the revenue under the act, these points are important in dollars and cents terms. The Comptroller and the Attorney General have on several occasions had to supplement the act with statements on the meaning of "radio and television." They have had to decide whether television sets were also radios, what to do about combination sets, and whether installed radios sold in cars are taxable.

Probably the most important interpretation made under the act was the decision of the Comptroller in 1948 to include television sets among radios for tax purposes.[53] This decision came at the time when television sales were booming, and it undoubtedly resulted in the state's receiving a substantial amount of revenue which it would not otherwise have gotten. However, the exact amount by which the state was benefited is not ascertainable because no separate records are kept of the tax accreditable to television sales. The Comptroller's decision to extend the radio tax to television sets was endorsed by the Legislature in the statutory revisions of 1950 and 1951.

The device of listing all cosmetics to be taxed has kept to a minimum the decisions required of the Attorney General and the Comptroller. Only

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[53] Letter of the Comptroller dated October 19, op. cit.

two general rulings have been issued. The Attorney General, at the request of the Comptroller, handed down an opinion with reference to permanent waving solutions. He decided that they are hair preparations within the meaning of the law and are, therefore, subject to the tax.[54] This brings within the scope of the act the ever-expanding market for home permanent wave kits as well as solutions used in beauty shops.

The Comptroller has indicated, in his notice to the dealers, that "medicated shampoos, or those claiming other benefits than cleansing alone, are subject to the tax..."[55] This clarification was needed because of the provision in the act which exempted soaps. If the shampoo claims to be more than a mere cleansing agent -- that is, a soap -- it is taxable as a hair preparation.

A better picture of the coverage of the Texas act can be gained by looking at the federal retailers' excise tax on "toilet preparations." The federal tax applies to a much wider variety of related substances than does the Texas tax. Toilet preparations are defined in the federal law as follows:

> Perfumes, essences, extracts, toilet waters, cosmetics, petroleum jellies, hair oils, pomades, hair dressings, hair restoratives, hair dyes, aromatic cachous, toilet powders and any similar substance, articles, or preparation, by whatsoever name known or distinguished; any of the above which are used or applied or intended to be used or applied for toilet purposes.[56]

Some of the most noticeable inclusions in the federal law beyond those in the state statute are perfumes, toilet waters, and toilet powders.

The General Assessment Picture

In the light of what has been said, a few general observations can be made on the assessment picture for the radio, cosmetics, and playing cards tax.

Actual assessment is not necessarily made through a simple addition of the prices of all covered items sold. At least for the smaller establishment, it may be approximation or mere guesswork on the part of the proprietor. The

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[54]Op. Tex. Atty. Gen. No. 0-4107 (October 18, 1941).

[55]Comptroller, "Notice to All Retail Dealers Selling New Radios, Cosmetics, and Playing Cards."

[56] U.S.C., 1948 ed., tit. 26, sec. 2402.

coverage of the tax is very general. The law does not specifically exempt any type or form of business engaged in retail selling.

There are, however, several exemptions on the items to be covered by the law. The tendency of interpretation by the Comptroller and the Attorney General has been expansive rather than restrictive, and there has been an attempt to keep the law abreast of the times through interpretation.

SECTION 4 - COLLECTION AND ENFORCEMENT

The collection and enforcement functions of the radio, cosmetics, and playing cards tax are assigned by law to the Comptroller. Responsibility for payment is placed upon the taxpayer and no instructions as to the Comptroller's handling of collections appear in the statute. He is given the power to make regulations or to require such reports "as will enable him to efficiently collect the tax." However, the rule-making power of the Comptroller has not been exercised in regard to collections.

Every person covered by the tax law is required on the first days of January, April, July, and October, to "pay to the Comptroller" the tax due. Beyond this, no collection procedure is set forth in the statute.

Enforcement of the tax also falls to the Comptroller, but this responsibility is rather indirectly assigned by the statute. Except to authorize a special fund for the use of the Comptroller "in the enforcement of this law," and to permit him "upon reasonable notice" to examine the books and records of taxpayers for the purpose of ascertaining corrections of taxes paid or of reports submitted, very little statutory direction is given in the matter of enforcement.[57] The statute does not expressly require records to be kept by the taxpayer, nor does it prescribe any frequency for audits or inspections by the administrator.

As has been noted, the day-to-day operation of the tax is carried on by the Store Tax Division, which, in effect, handles the collection function, and by the Cigarette Tax Division, which performs most of the enforcement functions.

The Ordinary Process of Collection

Retailers on the store tax lists receive, from the Store Tax Division, a tax form in triplicate prior to the time of filing each quarter. The form provides space for a statement of the gross receipts (number of decks in the case of cards) received from sales of each of the taxable commodities. It also has space for computing the tax on each of the commodities and a space for the total tax, since many taxpayers sell all three items.

Space is provided for a signature of the taxpayer and for a notary's seal. After completing the form, the taxpayer retains the third copy for his own records. For a few years after passage of the act, a receipt was mailed to the retailer, but in order to save postage, the third copy is now allowed to serve as a receipt. The original and duplicate are sent by the retailer, along with the tax payment, to the Store Tax Division in Austin. There the forms are checked

[57] Acts 47th Leg., R.S. 1941, ch. 184, Art. X, sec. 2.

for accuracy of computation and consistency with previous reports. The original of the tax report is kept on file by the Store Tax Division, and the duplicate goes to the district offices of the Cigarette Tax Division.

One file clerk and one auditor are the only personnel in the Store Tax Division whose work is primarily with the radio, cosmetics, and playing cards tax. However, when necessary, all other personnel in the division are used for processing the tax payments. Money collected is paid to the Treasurer by the Comptroller's Office.

Enforcement Procedures

In the event the Store Tax Division fails to receive a completed tax form from a retailer to whom blank forms were mailed, or if officials have reason to believe a seller is reporting inaccurately, they notify the appropriate district office of the Cigarette Tax Division. To do this, the Store Tax Division runs off on the addressograph machine a white slip of paper the size of the report form and forwards it to the district office. This is done once or twice each year for accounts which have not sent in completed tax forms.

When the field personnel have investigated a case, they return the slip of paper with the appropriate notation. Thus retailers who have gone out of business, moved, or discontinued selling the taxable commodities are noted, and the files of the Store Tax Division can be cleared of such listings. In cases where no tax return has been sent in by the retailer but a tax is due, field representatives collect taxes when the contact is made. The regular, triplicate, interleaved carbon tax forms provided for normal collections are used by field men when such collections are made.

Coverage

In this operational setting, the collection and enforcement of the radio, cosmetics and playing cards tax appears quite simple and precise. However, its actual application is neither.

One of the principal operating problems of the administrator of any tax is, of course, assurance of full coverage. This entails the dual consideration of whether all those liable for the tax are paying it and whether those paying the tax are making the full payment for which they are liable. Manifestly, the assurance of full coverage is a control problem. For the administrator of the radio-cosmetics-cards tax, no complete and easy controls are available. Reliance, of necessity, must be placed on the files of stores licensed under the Texas chain store tax law. Even a superficial observation of the store tax provides evidence that these have yielded only a partial listing of retailers in the state who may be doing business in the taxable commodities. The ex-

emptions in the chain store tax law include perhaps as many as 60,000 retailers.[58] Not all of the retailers exempt under the chain store tax are, of course, vendors of radios, cosmetics, or playing cards, but many are. To supplement the list, the Comptroller has publicized the requirements of the tax through trade magazines and other publications in order to evoke response from retailers who may be liable for the tax but who have not been paying it because they did not know of its existence. Apparently lists of retailers furnished by manufacturers of national brands of radios and cosmetics are not used, although such lists would provide an excellent supplementary control device. The merchandising practices in the industries, however, may make it difficult to get such lists.

The administrators of the radio, cosmetics, and playing cards tax estimate that approximately 24,000 to 26,000 accounts are active under this tax law. However, no precise figure is available, and indications are that some retailers who are liable for the tax are not paying it. This is borne out by occasional field collections which cover several years of tax delinquency. Whatever the number of taxpayers at present, it is impossible to assure that all who are liable for the tax are paying, since the full potential is not known.

A solution to this aspect of the coverage problem was provided by the Legislature in 1951 when amendments to the chain store tax inaugurated for the first time a registration procedure for all retailers, whether exempt from the store tax or not.[59] One of the effects of this change will be to provide the administrator of the radio-cosmetics-cards tax with a comprehensive list of all retailers in the state and thus make possible more complete coverage than has heretofore been possible.

As to the other aspect of the coverage problem--assurance that those paying the tax are making the full payment for which they are liable--considerable uncertainty exists. The tax report forms, as has previously been mentioned, show simply the total gross receipts of the retailer from radio and cosmetics sales during a three-month period. To these totals the retailer is required, by the statute, to attest by his sworn statement. Presumably, the totals shown on the tax form accurately represent the totals in his sales records.

However, there is no requirement, either in the statute or in any administrative regulation, that records of any kind be maintained by the retailer for verification of the tax returns. As a consequence, audits or inspections of retailers' books by the field men of the Comptroller's office are entirely dependent upon the situation in each retail establishment. Some maintain complete records, some very scanty records, and some none at all. Since there is no requirement that

[58] Texas Legislative Council, A Survey of Taxation in Texas--Part II: Analysis of Individual Taxes, March, 1951, p. 103.

[59] Acts 52nd Leg., R. S. 1951, ch. 402, sec. XVI, p. 713.

records, if kept, must be maintained for any length of time, even retailers who keep careful and detailed accounts may destroy their records before the Comptroller's field man calls -- not necessarily through malice but simply to clear an office file of old papers. When and if records are checked, even assuming that they are complete and accurate, audits are made with great speed by field men who, according to the administrators, may make up to 50 calls a day.

This situation poses a problem of considerable magnitude for the field agent of the Comptroller. Faced with responsibility to see that the tax paid is the full amount for which the retailer is liable, the field representative must work within the situation as it exists, with practically no enforcement tools to help him. As a consequence, administrative practices have developed whose merit is largely convenience and practicality. However, they may be questioned as to theory and in the light of the intent of the law.

Such practices include the use of the taxpayers' federal cosmetics tax records as a base for computing the state tax if other records are not available, the prevalent acceptance of the total prices on wholesalers' invoices plus a reasonable retailer's mark-up to arrive at sales totals, and the acceptance in some instances of the dealers' approximations of sales volume. It is evident that precision and accuracy are not assured by such procedures, but they do have the merit of being workable in application. Expedients of this sort in other state taxes have been frequently avoided by requirements that certain types of records be maintained by each taxpayer; that such records be kept for a specified period of time, or at least until audited by the Comptroller's office; and that agents of the Comptroller be permitted to inspect books, records, and premises of taxpayers at any time. Such inspection in the radio-cosmetics-cards tax is permitted only "upon reasonable notice" and is limited to records.

Delinquency and Evasions

In this environment, as in almost any in which a tax law functions, there are delinquencies and evasions of payment by taxpayers. The extent of such actions and the methods and degree of success in combating them are important in the evaluation of the administration of any tax; but due to the situation which surrounds the operation of the radio-cosmetics-cards tax, a look at the delinquency problem is particularly significant.

Since the tax becomes due and payable on the first day of each quarter, the failure of a store proprietor to pay the tax voluntarily on the day it comes due technically constitutes a delinquency. However, this tax law places no penalty on mere failure to file and pay the tax. For this reason, stores vending these items can simply fail to take any notice of the law until such time as they are discovered by a field inspector. Then they can pay the tax without being penalized for failure to do so at the proper time and, in addition, save themselves the nuisance and expense of notarization of the tax form. This is likely

to create the additional difficulty that merchants whose avoidance of the tax is not discovered for several years will, by the time payment is demanded, no longer have on hand adequate records through which the amount of tax can be computed. However, the seller is under no legal obligation to maintain a particular set of records, and there is no penalty for failure to keep records or for destroying those needed in computing the tax.

The law makes no provision for licensing dealers in radios, cosmetics, and playing cards. It does, however, make provision for action to collect the taxes due. It specifies that, should any person fail to make the required report or to pay the tax, this fact shall be reported to the Attorney General, who shall then institute appropriate legal action to obtain the amount due the state. He may also enjoin the defendant from the continued sale of articles taxable under the act until the taxes due have been paid. The latter is to be in addition to other remedies available to the state for collection of debts due it.[60]

The law further provides that any person who shall, after a written notice from the Comptroller and within 30 days, refuse and fail to make the report required by the act is guilty of a misdemeanor. The punishment, upon conviction, is a fine of not less than fifty and not more than one thousand dollars.[61] The sending of the tax form to the taxpayer quarterly has not been considered by the administrators as constituting the written notice required by this section of the law. No other notices are sent to taxpayers, so that in practice this provision of the law has been ineffective. It can be noted that this penalty provision deals with making a report and not with failure to pay the tax.

Lastly, the act declares that knowingly making a false report is perjury, with a punishment, upon conviction, of imprisonment in the penitentiary for not less than one nor more than three years.[62]

The enforcement provisions of the law have never been employed in the administration of these three taxes. There have been no instances in which the Attorney General has filed a suit for collection of the tax nor in which any person has been tried for perjury or for refusal to make the report required by the act. Accordingly, collection of the tax has been conducted without resort to the legally-provided enforcement provisions.

Two methods are used to collect from delinquents. The first is the simple one of continuing to mail out report forms each quarter to any store which has not been, for some definite reason, taken off the radio, cosmetics, and playing cards tax list. Some retailers allow themselves to be delinquent

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[60] Acts 47th Leg., R.S. 1941, ch. 184, Art. X, sec. 3.

[61] Ibid., sec. 5.

[62] Ibid., sec. 4.

for several quarters and then pay what they owe. The Store Tax Division does not, however, mail out specific notices of delinquency. Hence the provision which would impose a penalty for failure to file a report has not been put into operation. The second method is collection in the field. As has been indicated, a notice printed from an addressograph plate is sent out to the Cigarette Tax Division field force for each delinquency.

Neither the Cigarette Tax Division nor the Store Tax Division has any record of the total number of such notices sent to the field offices. Since there is no co-ordination of work loads assigned by the Austin offices to the field force, occasionally field personnel either have to cover the same area more than once to make prompt collections on all taxes or hold delinquency notices until a future itinerary again covers the area. There is no control procedure to follow up delinquencies, so that once a delinquency notice is sent to the field, it is not possible to find out conveniently whether any action has been taken on the case. To a certain extent, this situation will be remedied by the planned channelization of all field work assignments through the Austin office of the Cigarette Tax Division.

Field Enforcement

A sampling of the records covering a recent one-year period indicated that 20 per cent of the stores subject to the radio, cosmetics, and playing cards tax were delinquent. In view of the uncertain coverage (see discussion of this subject on preceding pages), it is possible that the percentage may actually be considerably higher. The survey was based on the taxpayers listed and does not take into consideration any stores which might be liable for the tax but are not known to the administrator. For the survey, a delinquency was considered to be a failure to report and pay the tax sometime during the three-month period following the due date. Field collections were shown to have been made against only four per cent of the stores subject to the tax. Thus it is apparent that a number of stores failing to make their quarterly reports were not checked by the field force. However, administrators expect that a recent increase in the Cigarette Tax Division field force will make possible a greater concentration on the radio, cosmetics, and playing cards tax.

The amount of delinquency varies from district to district. Some districts show a delinquency rate of 15 per cent, whereas others go as high as 35 per cent. Likewise, field collection shows an erratic pattern. Only one district seems to be making any sizable effort to catch up with failures to pay, and that in only a few counties. Most districts seem to have a tendency to allow a couple of years to elapse before collection is made. It should be noted, however, that the tendency to pay on time does not appear to be higher in districts pursuing a fairly strong field collection policy. There being no penalty for delinquency, some merchants apparently wait for the field collector to come around.

Looking further into the enforcement practices evidenced in the several districts, several things stand out regarding field collections. Particularly noticeable is the fact that very little correlation exists between field collections and delinquencies. Instead of the field force's being an enforcement device to collect delinquent accounts and to find tax evaders, it functions largely as a means of making what might be considered as current collections; that is, within three months following the due date. From the sample studied, there are strong indications that the greatest number of field collections are from stores which are not delinquent -- at least not for more than one quarter, and that a large number, if not most, of the stores showing prolonged delinquency (failure to report for four or more quarters) are infrequently contacted by field men. In many cases, collections appear to be regularly made by field men. A considerable number of stores show a field collection in every quarter of a year. This practice is particularly noticeable in larger cities.

Explanations for this probably lie in the facts that there is no centralized control of the work load in the field by the Austin office, that there is no follow-up on delinquency notices sent to the field by the Austin office, and that the field men quite naturally devote their time to the primary work of the division to which they are assigned -- i. e., enforcement of cigarette and coin-operated machine taxes and licenses. If field contacts for the work of the Cigarette Division happen to be near or the same as a contact for the radio-cosmetics-cards tax, then a collection for that tax is made. If the two do not coincide, however, there is a strong indication that no great effort is made to contact delinquents in the radio-cosmetics-cards tax category.

In one of the larger cities, it was indicated that almost 80 per cent of the stores contacted by field men during the year surveyed had a contact made every quarter. This, in effect, amounted to regular field collection of current taxes. During the same period in the same city, an almost equal number of stores which were delinquent for all four quarters had no field contacts during the year. In another city, it was indicated that well over half of the field collections made were picked up regularly -- a field collection each quarter for each of the stores. During the same period, a sizable number of stores in the same city, shown to be delinquent every quarter, had no field contacts made. [63]

Delinquencies appear predominantly among stores whose tax is small. About 90 per cent of the delinquents are stores owing less than five dollars. In many cases, the amount due is only a few cents. However, the pattern of field collections does not indicate that this factor has influenced the selection by the district offices of the accounts to be contacted, since the same percentage of small accounts appears among stores regularly contacted as among

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[63] In cases where a field contact is made but the taxpayer refuses or is unable to pay at the time of contact, the records reviewed do not always show a contact unless other action against the taxpayer has been taken. There is no indication that such cases are common.

others. A notable exception shows up in one of the larger cities, where a store which is consistently the fourth or fifth largest taxpayer (of the radio, cosmetics, and playing cards tax) in the state, apparently pays regularly through the Comptroller's field representative in the region instead of mailing its payment and report to the Austin office.

Field collections tend to be made more frequently in the cities than in the rural areas, although prolonged delinquencies are common in both.

Disposition of Revenues

The 1941 act provided that revenues from the radio, cosmetics, and playing cards tax shall be allocated as follows: Up to two per cent may be retained by the Comptroller for an enforcement fund; but if the Legislature makes a special appropriation for enforcement, that amount is to govern. After the amount required for enforcement has been removed, one-fourth of the remainder is to go to the Available School Fund and the rest to the Omnibus Tax Clearance Fund.[64] The revenues received by the Comptroller are usually turned over to the Treasurer within five days.

[64] Acts 47th Leg., R.S. 1941, ch. 184, Art. X, sec. 7, and Art. XX.

SECTION 5 - RESULTS OF OPERATION

Costs of Operation

Actual costs involved in the collection and enforcement of the radio, cosmetics, and playing cards tax cannot be accurately ascertained. Collection is combined with that of other taxes, and no cost accounting or analysis is maintained by the Store Tax or the Cigarette Tax Division. The Store Tax Division has previously been allocated five thousand dollars annually and, of recent years, nine thousand dollars, for the collection of this tax. However, these moneys go into the general costs of the division and are not specifically set aside for the administration of this particular tax.

The Annual Report of the Comptroller has regularly contained a table in which funds for the administration of each tax item are set forth; that is, radios, cosmetics, and playing cards. The following table presents the totals annually reported by the Comptroller for enforcement of the taxes levied by the radio, cosmetics, and playing cards tax act. It also shows total receipts collected annually under the act and the percentage reported as enforcement funds.

Total Annual Receipts and Enforcement Funds,
Radio, Cosmetics, and Playing Cards Tax,
1941-1950

Year	Receipts	Enforcement Fund	Percentage
1941	$ 38,572	$ 249	.00645
1942	384,375	7,522	.0195
1943	374,019	6,996	.0187
1944	346,370	7,262	.0209
1945	363,995	7,485	.0205
1946	441,581	8,290	.0187
1947	789,803	15,714	.0198
1948	881,608	17,302	.0196
1949	778,590	15,417	.0198
1950	929,132	17,707	.0190

SOURCE: Annual Reports of the Comptroller, 1941-1950.

The annual enforcement funds reported in the foregoing table are not computed through cost analysis and do not, therefore, necessarily provide an accurate picture of the actual relation between costs and revenues. They appear to be primarily bookkeeping entries required by law to account for expenditures in terms of specific divisions. This requirement would be extremely difficult to adhere to in practice.

In view of this lack of cost analysis, it is impossible to know relative expenses incurred for field collections of the tax and for the work of the Austin office. As a result, there is no method for ascertaining costs of collecting delinquent taxes and checking on stores which might be avoiding the tax as compared to revenues actually attributable to these operations. Field activities bring in only about five per cent of the annual total revenue from the radio, cosmetics, and playing cards tax. This picture is somewhat clouded, moreover, by the practice of the previously-mentioned large store which pays its tax on time through the field representative rather than mailing it directly to the Austin office. This store alone accounts for about one-half of the field collections. But by far the greatest number of field contacts result in very minor collections. The arithmetic average for field collections, excluding those from the store mentioned above, is between $15 and $20. Although it is clear that many accounts collected in the field do not pay for themselves, a precise determination of the costs of field collection in comparison with the revenue obtained in that way is impossible.

As indicated in Section 4, numerous questions as to administrative cost of enforcement and collection arise from a survey of present field methods. Lacking most of the police powers commonly granted field agents of tax administrators, the men handling enforcement of the radio-cosmetics-cards tax may be losing considerable effectiveness thereby. Also, due to lack of centralized direction of the field program, there are indications that a certain amount of duplication of work results. It can only be surmised whether the indications that numerous field collections are made of current taxes -- that is, a field collection made every quarter -- show an unnecessarily expensive way of collecting the tax. It is clear, however, if such practices are as prevalent as indicated in the surveyed sample, that a large number of payments made directly to field men are costing the state more than the amount of tax collected. The continuance of such practice regularly each quarter is open to serious question on the basis of administrative cost. Too, the utilization of field time for such purposes may prevent contacts of the more prolonged delinquencies.

Since there have been no court cases in connection with the radio, cosmetics, and playing cards tax act no litigation costs have been incurred. All enforcement and collection costs have been administrative.

Tax Receipts

The following table lists annual total receipts from the radio, cosmetics, and playing cards tax, the portion of each tax dollar derived from this tax, and a breakdown of receipts in accordance with amounts received from radios (including television since 1948), cosmetics, and playing cards, respectively.

Annual Income from the Radio, Cosmetics, and Playing Cards Tax and the Cents of Each Tax Dollar Supplied Thereby

Year	Total Receipts	Percentage of Each Tax Dollar	Radio Receipts	Cosmetics Receipts	Playing Cards Receipts
1941	$ 38,572	.0002	$ 18,824	$ 17,157	$ 2,590
1942	384,375	.0017	177,210	182,150	25,015
1943	374,019	.0015	110,044	235,852	28,122
1944	346,370	.0014	13,547	299,987	32,836
1945	363,995	.0014	2,688	327,633	33,674
1946	441,580	.0014	64,105	343,872	33,604
1947	789,803	.0021	434,243	324,564	30,996
1948	881,608	.0017	544,220	308,238	29,149
1949	779,590	.0015	434,607	315,648	29,336
1950	929,132	.0017	542,754	343,958	42,420

SOURCE: Annual Reports of the Comptroller, 1941-1950.

This table shows a pattern clearly marked by World War II and its aftermath. Although the war-time variation in total receipts was not great, dropping less than forty thousand dollars between 1942, the first full year of collection, and 1944, the low war year, the amount obtained from radio sales tax decreased precipitously, while that from cosmetics increased substantially. The rise in cosmetics sales tended to offset the decrease in radio sales, thereby preventing wide fluctuation in the totals.

The post-war boom can be clearly seen in receipts from the radio, cosmetics, and playing cards tax. Being consumer goods, these items reflect the pent-up purchasing power which burst forth after peace was restored. However, the real increase in demand was for radios and, of course, television sets. Cosmetics revenue actually declined slightly in the immediate post-war period but is again trending upward. The largest single post-war source of revenue, among those here being considered, is radio and television sales. Since 1947, the radio tax has brought in over half of the total.

If the television boom continues, and it has barely begun in Texas, it can be expected to yield the most important part of the tax. At the same time, television sales may be somewhat erratic over the years because of difficulties in extending television broadcast networks and because of defense demands.

The playing cards tax accounts for a very small portion of the revenue received. In the years since the war, from 1947 to the present, it has

provided only about four per cent of the income from the tax. The sudden 1950 increase, according to some, is attributable to the popularity of canasta and the fact that there has been a recent decrease in "going out," indicated by the drop in movie and night club attendance, which is often explained as due to the inflationary pinch of recent years.

Approximately 24,000 to 26,000 retailers pay the radio, cosmetics, and playing cards tax. Assuming that 25 thousand is the average number of payers, the average annual payment in 1950 would be around $35.

However, the average payment gives an unrealistic picture of the actual collections. This is particularly evident in regard to collections from the radio tax, where ten taxpayers, representing probably less than one-tenth of one per cent of the total number, accounted for 40 per cent of the revenues collected. In regard to cosmetics collections, however, the situation is considerably different. Here, although the 20 largest taxpayers account for almost 20 per cent of the revenues, the great bulk of the collections come from thousands of small retailers. It is readily evident that the collection and enforcement problems of the two levies are greatly dissimilar.

Lack of a Use Tax Provision

The radio, cosmetics, and playing cards tax act does not contain a use tax provision. There are no available estimates on what additional revenue would be received from such a provision. The effect of the absence of a use tax clause is, of course, to prevent collection of the tax on items shipped into the state through interstate commerce directly to the consumer.

Analysis of Rates

Since special radio, cosmetics, or playing cards taxes are little used in other jurisdictions, there is insufficient basis for comparison. However, if the Texas tax is compared with sales taxes in other states, it will be found that the Texas charge on radios and cosmetics is near to the prevailing rate. As has been pointed out, the usual rate of a general sales tax is two per cent. The next most common rate is three per cent. The Texas tax is at present between these, being closer to two per cent. It is also possible to compare the state tax on cosmetics with that of the federal government. The federal retail sales tax on toilet articles is 20 per cent, substantially larger than the Texas tax.

The Texas rate for playing cards is probably low compared to that in the few other jurisdictions singling out playing cards for special tax attention. In both South Carolina and Alabama, the tax is 20 per cent of the selling price, or one cent out of every five. The federal tax, which is collected from manufacturers and importers, is presently 13 cents on the pack.

Any comparison between the Texas receipts from these taxes and those received by other states would be precarious, even if comparable data were available. However, it might be worthwhile to consider the relative amounts received by the federal and state governments from their respective taxes on cosmetics in the State of Texas. To do this, it is necessary to compensate for the difference in rates by computing what federal tax receipts would have been had they been collected at the Texas rate.

Except for the first two years of federal tax operation, the pattern of federal and state cosmetics tax collections in Texas is very similar. Possibly due to the different fiscal years used by the state and the national government and the different periods of collection, changes in the revenue trend seem to appear in the state totals slightly earlier than in the federal totals. For example, state collections climbed each year until 1946, reaching a peak in that year. The trend, down in 1947 and again in 1948, began to swing up again in 1949 and continued up in 1950. Federal collections in Texas, adjusted for rates, show the same fluctuations except that the peak of collections occurred in 1947 and the recent upswing was reflected in 1950.[65] Taking into consideration the time lag evidenced in federal collections, the parallel between state and federal collections is quite marked. The national levy has been consistently productive of from 22 to 24 per cent greater income than the state tax, even after adjustment is made for difference in rates. Whether this is due wholly to the fact that the federal act taxes a greater number of items or whether it is partly due to more complete collections by the federal government cannot be readily determined.

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[65] Data on federal collections have been obtained from the Annual Report of the Commissioner of Internal Revenue for the years indicated.

SECTION 6 - SUMMARY AND PROBLEM AREAS

It is apparent from the preceding discussion that the radio, cosmetics, and playing cards tax, like most state taxes, operates reasonably well and without undue difficulty for either administrator or taxpayer. However, to achieve this relatively smooth functioning, a number of techniques of administration have been adopted, and policy decisions have been made which have substantially modified the tax law and in some instances altered it. Such modification and changes represent growth and development patterns common to all tax laws. The practical application of any tax statute necessitates some modifications, alterations, and additions to the letter of the law, for the environment in which a tax functions is never static. Particularly is this true during the early years of operation.

The purpose of this section is, in part, to present for legislative review some of the more significant developments which have occurred in the operation of this tax law. Perhaps all these modifications and interpretations have been fully in keeping with the intent behind the law. If such is the situation, it may be desirable to have legislative approval of those developments which do not have express statutory sanction. On the other hand, a legislative review of the development of this tax law may indicate that there have been deviations from the intent of the Legislature. Inadvertent as such possible deviations may be, it is important that the Legislature know the effects of and the reasons for them so that such changes as legislators feel are necessary can be made.

This section is also intended to serve the purpose of discussing those matters which present operational or policy problems and those areas of tax administration which, though reasonably satisfactory now, could possibly be improved. Methods which could be used in dealing with the problem areas are indicated. However, no method considered is intended as a recommendation or proposal. Rather, this discussion is designed to present problems and mention some possible approaches to their solutions. It is hoped that the points may be thought-provoking and helpful to any careful legislative review of the tax.

The following might be designated as the problem areas of the radio, cosmetics, and playing cards tax:

(1) Lack of effective coverage control to assure full payment of the tax by all who are liable for it.
(2) Lack of effective enforcement authority and procedure.
(3) Lack of statutory direction in many matters of policy and practice.
(4) Organizational structure lacking in effective co-ordination.

Coverage

As has been indicated in Section 4, tax coverage involves two considerations: one, assurance that all who are liable for the tax are paying it; and two, assurance that payments made represent the full tax liability. The importance of assuring as complete tax coverage as possible lies not only in the fact that without it the state is losing revenues it should be getting, but particularly in building public confidence that the tax is being applied equally against all who are liable. Lack of complete coverage tends to favor the dishonest and the inefficient and reduces the respect of people for their government. Widespread tax evasion means, in a very real sense, that those who are paying the tax are being discriminated against and may be put at a competitive disadvantage.

To assure payments from all who are liable, a number of tax laws have licensing provisions. However, many of the radio-cosmetics-playing cards taxpayers are already licensed under the chain store tax. Since the extension of the registration feature of this tax in 1951, a much greater list of potential taxpayers will be available to the administrator. Hence it may justifiably be assumed that through the new provisions of the chain store tax, an adequate control for one aspect of the coverage problem of the radio-cosmetics-cards tax will be provided. In other words, the coverage problem of identifying all retailers who are liable for the tax, currently one of the most serious in the administration of the radio-cosmetics-cards tax, may be expected to be solved in large part by the new provisions of the chain store tax law. It must be remembered, however, that the chain store lists will contain the names of many retailers not liable for the radio, cosmetics, and playing cards tax, and that it may require some time to sift these out and establish a true list of taxpayers for the latter tax.

But even with lists containing the names of all those who may be liable for the tax, there would still be considerable question whether everyone is paying the tax who is subject to it under the present methods of administration. This results from lack of follow-up on notices sent to taxpayers. The total number of taxpayers who have ignored the tax forms sent them is not known, nor is the duration of such failure to report known. Thus, however complete the lists of retailers liable for the tax may be, payment may not be received from all of these if present methods are continued. To correct the situation, a system of penalties might be instituted.

However, penalties admittedly do not provide a complete solution. Particularly is this true if the penalties are unrealistic and difficult to apply. As has been discussed in Section 4, it is possible for legal action to be instituted through the Attorney General under certain conditions of failure to

report and failure to pay. However, this penalty provision has not been invoked for enforcement of the tax. In most cases, it would be impractical because the procedure is expensive and time-consuming. Delinquencies usually involve small amounts, and it is not possible to ascertain whether there is actual intent to evade or whether delinquencies are largely the product of carelessness and indifference. As was the case with the chain store tax prior to the 1951 amendments, it is in many cases simply easier, more convenient, and less expensive to be delinquent than to pay the tax at the required time.[66] Court action against delinquents would in most cases be more expensive than the amount of collection involved, and popular reaction to such litigation would frequently prevent success by the state in its prosecution, since past experience of tax administrators indicates that juries are loathe to punish offenders of this type.

Nonetheless, it must not be assumed that penalty provisions as such are ineffective. Instead, it would be well to examine the various types of penalties. Administrators generally seem to agree that reasonable monetary penalties automatically applicable for failure to live up to the law and not requiring court action to be effective are preferable to severe penalties and those requiring involved legal action. The latter is the only type of penalty currently available for use by administrators of the radio-cosmetics-cards tax. Knowing that such a penalty is difficult to apply, the lax taxpayer is actually encouraged in his delinquent ways by the absence of any more practical means of penalizing him.

Express statutory requirement that all tax report forms sent to retailers be returned, even when the report is negative, and that such retailers be automatically assessed a nominal monetary penalty for failure to make a return may help to keep the files clear of inactive accounts. Under present procedures, unless contacted by a field man, a retailer who has discontinued sales of taxable items but has not notified the tax administrator will continue to receive report forms quarterly and his name will remain in the administrator's active file. As discussed in Sections 4 and 5, the likelihood of field contact is not great, at least until taxpayers have been delinquent for a considerable time. As a consequence, not only are a number of retailers avoiding payment of the tax, but the tax list is burdened by names of retailers not liable. Of course, exemptions from penalties should be made for retailers who discontinue the sale of the taxable commodities or have never handled them and who have notified the Comptroller to that effect, but by inadvertence or error have been sent report forms.

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[66] See Discussion in Texas Legislative Council, _A Survey of Taxation in Texas--Part II: Analysis of Individual Taxes_, Staff Research Report No. 51-8, p. 104.

An express penalty provision automatically applicable against a retailer who fails to notify the Comptroller that he has added the taxable commodities to his sales line is another device which would tend to give greater assurance of complete coverage. To some extent, this would lighten the load of field enforcement. At present, such evasion of the tax could go on for years and, when discovered by the administrator, no penalty could be assessed. If, however, a monetary penalty could be applied against such retailer for failure to notify in addition to whatever other penalties might be applied for failure to pay, there would be more reason for dealers to be prompt in making known their liability. The fact that everyone knows the law is a judicial presumption of convenience and one not based on fact. If the penalty were very severe, some injustice might result. But perhaps there is no other workable rule than the assumption that total tax evasion was willful. On this assumption, a penalty is, of course, fully justifiable. If the penalty is not too severe, the hardship resulting from a genuine case of ignorance would not be unreasonable.

Coverage: Records and Reports

The second aspect of coverage, i. e., the question of whether payments made are the full amounts for which taxpayers are liable, is largely dependent upon the use of records and reports and the accuracy thereof.

On several occasions in this chapter, it has been necessary to note that the assessment of the taxes required by this law devolves, in many cases, into guesswork, or horsetrading. As has been noted in earlier sections, this is the only feasible method in the absence of records. There is no specific requirement in the law that the dealer keep adequate records which can be used for computing the tax which will be available for inspection by the Comptroller. However, there is a section stating that the "Comptroller shall make such rules and regulations and require such reports as will enable him to efficiently collect the tax hereby levied." [67] The Comptroller has not attempted to exercise this authority, probably because of the lack of a clear provision for enforcing the maintenance of records.

As a result of the inadequate records kept by a large number of retailers, the provision for inspection by the Comptroller is, in many instances, nullified. There is often nothing for him to inspect. This state of affairs is entirely unrealistic and often makes enforcement of the tax an arbitrary process. The state is undoubtedly losing substantial amounts of revenue unless it can be assumed that the dealers not maintaining records or keeping only scanty records have a tendency to overestimate the tax they owe. On the

[67] Acts 47th Leg., R.S., 1941, ch. 184, Art. X, sec. 2.

other hand, the expedient of using federal toilet preparations tax records as a base for computing the state cosmetics tax involves the collection of a tax on items not covered by the law. But there is even more to this matter. Such conditions tend to breed contempt for the law and the habit of disregarding it, not only for the taxpayer but for the tax collector.

It seems clear that the problem of keeping records for assessment should receive the attention of all those who have an interest in the proper administration of the radio, cosmetics, and playing cards tax. Such records, if required, would not need to be complex. Accordingly, keeping them would not place an unreasonable burden on the small storekeeper.

One possible approach to this problem of record keeping would be to have the Comptroller prescribe the form to be followed and the times and places at which these records should be available. Exceptions could be made for those concerns which already have standard bookkeeping systems, provided the system used shows clearly the information needed for computation of the tax. The Comptroller might also require the preservation, for a definite period, of supplementary materials, such as wholesalers' invoices or sales tickets, which might be of value in checking accuracy of the reports submitted by retailers. But even if records were required, there would undoubtedly still be cases where none in fact were being kept. In such situations, where guesswork would still have to apply, the field man would be greatly aided by express guides as to what to do. A standard operating procedure might be set up, indicating such things as amount of mark-up which should be used in computing the tax, how the federal tax could be used to compute the state tax, and the like. With this kind of guide, the field man's work would be simplified, and he would have express authority in cases when records were not kept.

The power to prescribe that records be kept would not be meaningful without an attached penalty for failure to do so. This penalty could take a variety of forms. One alternative is to make refusal and failure to keep proper records a misdemeanor, or a flat rate penalty might be considered. It might be possible to use a combination of these in which a flat rate might be added for the first failure, and subsequent failures would be made misdemeanors. The advantage of the flat-rate penalty is that it appropriately covers the small storekeepers likely to be the most common offenders and avoids the cumbersome legal processes of taking all such matters into the courts. Backed up by a misdemeanor punishment for the second failure, this provision would not make it advantageous to a big storekeeper to fail to keep records as a means of saving himself more than the flat rate penalty would cost. However, this is not the only system which could be used, and it is submitted only as a possibility. Other methods might be more satisfactory.

In addition to records, reports are generally recognized as outstandingly helpful in assuring coverage of a tax law. Present practice requires the taxpayer to submit but one very simple report. Its advantages are several. By using a preprinted, interleaved carbon, triplicate form, the operations dealing with notifications of the taxpayer, computation by the taxpayer, recording of tax payment at the central and district offices, and receipting for tax payment all involve only one form. From the viewpoint of efficiency, it is commendable.

However, the extreme brevity of the report form amd the way it is used make difficult any central office audit which would reveal instances of failure to pay the full tax due. In other words, the report form in use shows so little information that it provides practically no check as to accuracy or completeness. As a consequence, full coverage can be assured only by field audit of the taxpayer's records. That this is not done, and in reality cannot be fully accomplished even if attempted, has been brought out in the earlier discussion. Field audits and inspections, it must be remembered, are expensive means of enforcement.

The following example is typical of a situation which quite frequently arises. A field contact is made at the store of a taxpayer who has been delinquent for some time. It turns out that he has not paid the tax for two years. A total agreeable to both the taxpayer and the field man from the Comptroller's office is reached, and tax payment is made. Actual sales records are nonexistent, but on the basis of invoices and similar documents, the tax is determined with as much accuracy as possible under the circumstances. A simple notation is made on one line of the form stating that the payment covers the entire two-year period. Being collected in the field, it is not notarized. It may or may not be signed by the person making payment.

The form, after it is received at the Austin office, almost has to be accepted at face value. It can be evidenced by the taxpayer as a valid receipt covering the period in question. Although there is no evidence of dishonesty in any of the records -- and it is definitely not intended that any such inference be made from these comments -- it is obvious that opportunity for dishonesty and collusion is ever-present in such a situation. Human nature is not incorruptible, and the present situation needlessly invites corruption.

As a solution to the problem, any one of several procedures could be used. None would give complete assurance of honesty, of course, and none would guarantee full payment by all taxpayers. But in some respects it can be argued that these procedures would tend to improve the present situation. With reference to the reports themselves, a required separate report form for each quarter -- perhaps even showing monthly volume of sales for each taxable commodity for the year -- might be of considerable help. Office audits or checks, when based on a series of monthly or even quarterly figures , would be more apt to identify errors of payment or possible cases of

evasion. Required record systems maintained by taxpayers would permit accurate spot audits to be made in the field. These are much less expensive and in most cases fully as practical as complete audits.

However, the matters of reports, records, evasions, and penalties can be seen in their proper perspective only when considered in the light of tax enforcement as a whole, not from the viewpoint of the coverage problem alone.

Enforcement

The difficulties attending enforcement of the radio, cosmetics, and playing cards tax have been discussed in earlier sections. At present, enforcement of the law is spotty and irregular. Lacking working tools, the field force has to accept the situation as it exists, and as a consequence, field expedients have to a pronounced extent been substituted for positive enforcement policy. Of course, considerable improvement in enforcement could be achieved under present conditions. However, even with the best possible effort and maximum efficiency, the enforcement function could not be carried out in a truly satisfactory manner as the situation now stands. And indications are strong that optimum performance is not being approached today.

Working tools, the lack of which was mentioned above, include authority to inspect records and premises of taxpayers and the authority to suspend or revoke store licenses or the right to impose penalties. These are part of the police powers [68] of an administrator and are devices through which enforcement can be made effective.

As has been mentioned earlier, the Comptroller is, under the present law, authorized to inspect records of taxpayers -- but only upon "reasonable notice." No determination of reasonable notice has been made; no difficulties have thus far been encountered by the Comptroller's field men. Since it has caused no difficulty, there has been a general tendency on the part of administrators to ignore its potential implications. However, in view of the fact that this provision is somewhat unusual as compared with other Texas tax statutes, there might be some justification for its elimination from the law or, at best, clarification of its intent. The expression very possibly was intended to mean inspection during business hours and may have been borrowed from the case law doctrine regarding the right of stockholders to inspect company books which was developed to prevent harassment of the company. However, as an enforcement device, inspection of records loses much of its value if notice of such inspection has to be given.

[68] The term "police powers" is used here in its broad and popular connotation. It is understood, of course, that it is frequently used in a much more restricted sense.

There has never been in the tax statute or in the regulations of the Comptroller any requirement that records of any kind be maintained nor that records, if kept, be maintained for any specified time to prevent destruction before an audit is made. Manifestly, field audits can be at best scarcely more than approximations. Not only is this situation troublesome in regard to coverage, as has been discussed above, but it makes virtually impossible any accurate enforcement activity by the field force. The field force lacks a most essential tool -- records which permit accurate check of tax liability. Underlying the problem of enforcement is, of course, the tax evader. If it were not for him, enforcement measures in contrast to routine collection procedures would be quite unnecessary, since normal collections would take care of the tax administration. Since the enforcement function, particularly when it requires the use of field organizations, is the most expensive part of tax administration, it is just as important to reduce the enforcement work load as much as possible as to make it possible for enforcement personnel to carry out their function successfully.

In this tax, such a reduction of enforcement work load -- i. e., that work required to carry out the tax law beyond the needs of administering the normal collection process -- and expense could possibly be achieved by addition of a few penalty provisions. If the taxpayer were allowed a full month after the close of a quarter to submit his report and payment, it would certainly not be unreasonable to have an automatic penalty apply for any payments later than that date. Applied as a percentage of tax due, with a minimum of five or ten dollars, the penalty would cause a taxpayer who has heretofore simply waited for a field man to appear and collect the tax to think twice about such delay. Interest on back taxes could also be required to further discourage delinquencies. This is impossible under the present law.

Additionally, and most importantly from the viewpoint of administrative cost, a service charge for every field collection made would tend to discourage the present prevalent laxity in prompt submission of payments. Such a service charge -- perhaps five dollars as for the store tax -- would help reduce the cost of field collections. Thus, the law could accept, as present practice already does, the habit of late tax payment to field agents, but the state would not be forced to pay the current high enforcement cost. The service charge would also tend to break the present costly enforcement habits of large-city stores which have field men collect the tax each quarter. As a result, the Comptroller's field agents would have more time for other contacts.

Making the tax due and payable on the day after the quarter for which payment is being made is unrealistic. Technically, the taxpayer is delinquent the day after the quarter ends. If penalty provisions for delinquency are imposed, a reasonable period -- perhaps one month -- should be permitted for submission of the tax.

Questions of Policy: Exemptions

Since car radios have been held by the Attorney General to be liable for the motor vehicle sales tax and not the radio tax, such radios require a lesser payment than do those not sold with cars. Legislative endorsement of this interpretation may be desirable in the event a question on this matter ever reaches the courts. Additionally, since administrators of the two taxes occasionally raise the question of whether the full price of a car radio is actually computed in all cases for the motor vehicle tax, it has been suggested that the affidavit form required for the motor vehicle sales tax be amended to add space for separate listing of a car radio.

In the matter of radio combinations, the law does not give any express indication of legislative intent. The Attorney General, as mentioned above (Section 3), has ruled that the entire cost of the combination be used in computing the tax when prices are not quoted separately. The policy of the Comptroller's office has been to receive payment on the total cost of the combination. It may be that the Legislature wishes to insure that the tax is levied on the entire cost of the combination whether prices are posted separately for components or not. In any event, legislative clarification would avoid possible future conflict on this point.

Although it may not be the intent of the radio tax law to include carrying and installation charges in the "gross receipts" for a particular sale, the Legislature may find it desirable to exclude such charges expressly in the statute and thus bolster the Attorney General's opinion on this subject. Likewise, legislative determination of whether or not "make-your-own" radio and television kits come within the tax law may be desirable. Such additions to the law simply keep the statute up-to-date, expressly indicate legislative desires on matters of policy which have arisen, and simplify the task of the taxpayer by making available in the law all the information he needs as to his liability without requiring him to search for copies of Attorney General's opinions.

An important consideration in regard to exemptions is the matter of a "use clause." At present, radios, cosmetics, and playing cards shipped to the purchaser from out-of-state are tax-free. The volume of such transactions is not known, but administrators indicate it is sizable. A "use clause" levying a tax on the first use of such commodities in the state in cases where no intrastate sale had previously occurred would permit tax collections on all the taxable articles -- not just those sold in the state. Similar provisions can be found in the cigarette tax law and in the 1951 amendment to the motor vehicle sales tax law.

Organization

As has been mentioned on several occasions, the big failings in connection with utilization of the field force stem from the fact that the field men serve two essentially isolated masters, that there is no clear policy laid down for them to follow, and that no method exists for checking on the quality of their work. Both the Store Tax Division and the Cigarette Tax Division rule the field force through a system of remote control and without regular consultation with one another. No provisions are extant for insuring that field personnel are given a steady and proper work load. At some points, they may be deluged with delinquency reports from both divisions. Moreover, the timing of these requests for checking delinquencies may be such as to necessitate redoing an area just completed. The field areas are not so small as to make this a matter to be taken lightly. But even if the Store Tax Division and the Cigarette Tax Division could be gotten together on such matters as times for sending out delinquency reports, there would still remain such important factors as deciding relative amounts of time and effort to be given to the collection of the several taxes for which the field force is responsible and of setting in operation a system for guaranteeing that the plan is adhered to.

There is no simple canned solution for difficulties of this kind. No matter what provision is made in law, the ultimate answer lies in active and imaginative action on the part of those charged with enforcement of the tax laws. However, the problem might be somewhat simplified if all taxes collected by a particular field force were put within one division and, therefore, under the control of one man. The division to which the field force is attached is certain to administratively favor the collection of its own taxes over those of another division, regardless of the relative importance of the taxes themselves. Moreover, the satisfactory operation of a system in which two divisions are using the same field force depends too heavily on the existence of cordial relations between the heads of the divisions. While such relations may at times be present, they are not assured. The state, if it relies on such a system of divided responsibility for the tax collection, is depending to an unnecessary degree on personal relationships. While such relationships are always highly important in the operation of any administrative organization, there is no particular reason for magnifying their significance more than is required by the generally-recognized limitations on all organizational arrangements. As mentioned earlier, the State Auditor recommended some years ago that the Cigarette and Store Tax Divisions be combined.

Once a unified and integrated administrative organization has been established, it would be reasonable to expect a well-thought-out and carefully planned utilization of available field forces in collection and enforcement of the various taxes which are their responsibility. Moreover, methods of checking on field work could be devised as they have been in other jurisdictions. These, however, seem to be matters which would have to be worked

out by the responsible officials. Detailed instructions in law concerning administrative operation of the field force might, in the long run, result in more harm than good. Such instructions cannot allow for the flexibility needed in the work-a-day business of collecting the state's taxes.

In Conclusion

Lacking teeth for enforcement, the radio-cosmetics-playing cards tax law presents the administrator with a difficult task. In spite of this, however, the tax has been a consistent revenue-producer and indicates a strong growth potential for coming years. Increases in revenue from this tax, however, depend to a great extent on future restrictions which might be imposed on civilian radio and television manufacture in case of war and upon the effort made to improve and make realistic the administration of the tax.

Chapter II

THE GROSS PREMIUMS TAX

SECTION I - HISTORICAL AND LEGAL DEVELOPMENT

Insurance is a subject which has no starting point in history -- at least, none that can be found. When the historians go back as far as they can, they find the practice being employed to meet the problems of the times. And when they go beyond the periods for which they can find direct documentation, they find the idea of this practice being used by the ancients.

The idea of insurance was known to the early Egyptians around 4000 B.C. and formed the basis of a practice known as respondentia, whereby itinerant merchants who traveled abroad from Egypt to sell the goods of another were excused from being sold into slavery for failure to account for the goods upon their return if they could prove that the goods had been lost due to robbers, the perils of the sea, or other such hazards. [1]

Insurance is frequently talked about today in a general and all-inclusive manner, and the expression "insurance business" often is intended to encompass all forms of insurance. However, a distinction is frequently made between companies writing personal insurance (life, accident, health, etc.) and those writing property insurance (fire, marine, casualty, surety, etc.). These two categories of the insurance field come from widely divergent sources not originally recognized as even involving the same principle.

Property insurance had its origin in the respondentia bond and the bottomery contract. These were in the nature of loan transactions. The owner of a ship, for instance, would borrow money for a voyage on a bottomery contract with the stipulation that if the ship was lost due to perils of the sea, he would not be required to repay the loan. Respondentia worked the same way for the Egyptians on land voyages and later for maritime states in respect to cargoes in ocean voyages.

Personal insurance begins to be documented in history with the advent of the Roman <u>Collegia Tenuiorum.</u> These were organizations of workers to provide for death benefits and burial expenses in return for the payment of initiation fees and certain monthly dues. [2] The same idea is again found in the guilds of the Middle Ages. The guilds compensated not only for the hardships attendant upon death but offered a form of indemnity to

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[1] C. F. Trennery, <u>The Origin and Early History of Insurance</u> (London: P. S. King & Sons, Ltd., 1926).

[2] John H. Magee, <u>General Insurance</u> (Chicago: Richard D. Irwin, 1947), p. 6.

members who had suffered losses due to fire, flood, robbery, and other such causes.

Insurance as a specialized modern business is usually regarded as beginning with the underwriting activities at Lloyd's Coffeehouse in London in the early 1690's, though life policies are known to have been written in London as early as 1583.[3]

Fire insurance was known in England prior to the Great Fire of 1666 but was little used. When 85 per cent of the buildings of London were destroyed in that conflagration, fire insurance received a sudden impetus.

Early American Insurance Development

The first efforts to meet the fire threat in the United States were in the formation of fire-fighting companies. Benjamin Franklin organized the first one in Philadelphia in 1730, but the first fire insurance company was not organized until 1752. It was the Philadelphia Contributionship, and Franklin was its first director. Though this was the first insurance company in the new world, American financial interests had been underwriting marine risks plying between England and the colonies since 1682.

The first life insurance company to be chartered in this country was that of the Presbyterian Ministers' Fund in 1759. Operating in the Province of Pennsylvania this organization confined its activities largely to writing life insurance for clergymen. In the half century following, stock companies made a start, and life insurance as a business institution was established in the United States.[4] At first, people did not seem to understand or trust the life companies. In 1800, it is estimated, there were not more than 100 policyholders in the country. By the outbreak of the Civil War there were 56,000 policies outstanding in New York alone.[5]

As the insurance business gradually grew into a position of increasing importance and became financially a significant part of the economy of the country, its regulation and control by the states and its status as a source of revenue became a matter of interest. Early regu-

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[3] Ibid., p. 12.

[4] Magee, op. cit., p. 20

[5] Edward L. Scheufler, Insurance Taxation in the State Economy, reprinted in part in Harold M. Groves, Viewpoints on Public Finance (New York: Henry Holt and Co., 1947), p. 313.

lation manifested itself through taxation. As early as 1819 Connecticut taxed insurance companies and banks at six per cent of "their value." In 1824, New York imposed a tax of ten per cent on all premiums collected on New York risks by foreign fire insurance companies (those chartered in other states). Vermont levied the same type of tax with an eight per cent rate in 1825 and Massachusetts imposed a slightly different tax in 1832.[6] The Massachusetts levy was the type known as a "reciprocal act," or retaliatory tax, which became very common in the years that followed and was eventually enacted by practically every state. Not until 1945, when the United States Supreme Court held insurance to be interstate commerce, did the retaliatory feature disappear from state insurance tax laws. In most cases, the early acts were not primarily revenue measures but regulatory devices against out-of-state insurance concerns. Taxes on domestic insurance companies were generally enacted some years after the taxes on foreign companies.

In 1835 the New York fire, with its loss of $20 million of property, caused the failure of a number of fire insurance companies. Taking caution from the example of New York, Massachusetts enacted, in 1837, legislation for fire insurance companies requiring the maintenance of certain funds to insure ability to carry out the contracts. This date is generally recognized as the beginning of state regulation of the insurance business.

Massachusetts also led in the regulation of life insurance companies.[7] Its insurance department, established shortly before the Civil War, initiated some sound and needed administrative practices. New York, Connecticut, and Ohio followed Massachusetts' lead. The financial panic of 1873, in which many insurance companies failed, and the widespread abuses to which the insurance trade had been subjected caused other states to organize insurance departments.[8] Texas was in this group. It established a department of "insurance, statistics, and history" in 1876.[9]

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[6] For a discussion of the early state taxes on insurance companies, see Edwin R. A. Seligman, Essays in Taxation (New York: Macmillan Co., 1925), p. 161 et. seq.

[7] Magee, op. cit. pp. 22, 134.

[8] Patterson, The Insurance Commissioner in the United States (Cambridge: Harvard University Press, 1927), pp. 519-537.

[9] Acts 15th Leg., R. S. 1876, ch. 133, p. 219.

The First Texas Insurance Tax

Preceding this by a number of years, however, was the first Texas insurance tax passed in 1862, the same year California, which had for some years had a flat-rate levy on insurance companies, passed its first gross premiums tax.[10] It is interesting to note that during this period, before the close of the Civil War, the federal government levied a special tax on insurance companies. This was in the nature of a gross receipts tax placed on the railroads, insurance companies, and other such corporations. It was repealed shortly thereafter.[11]

Thus it can be seen that by the time Texas got around to levying its first insurance tax in 1862 and to the establishment of an insurance department in 1876, neither the impost nor the agency was unique.

In the early period of Texas insurance taxation, we find considerable experimentation. A gross premiums tax would hardly have been feasible at that point because Texas had no administrative machinery to check on the accuracy of such a tax. The department of history, insurance, and statistics had not been created.

The first Texas tax on insurance companies was an occupation tax. It was to become the patriarch of a long line of occupation taxes extending all the way to the present. As the line of descent is traced, several distinct stages of development appear. Commencing with the earliest and coming down to the present, their sequence may be denominated: Flat Amount, Flat Amount - Gross Receipts, Gross Receipts, Flat Amount, and finally, Gross Premiums.

The first tax imposed on insurance companies as such (they have always been subject to ad valorem taxation) was a flat amount.[12] It was in the form of an occupation tax and was only one item in a tax bill covering a multitude of other occupations, ranging from running an "eating house" to the practice of law and medicine. The tax levied against insurance companies was $50 per year.

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[10] Report of the Senate Interim Committee on State and Local Taxation, California Legislature, 1951, p. 233.

[11] William J. Schultze, American Public Finance (New York, Prentice Hall, 1938), p. 301.

[12] Acts 9th Leg., R. S., 1862, ch. 71, p. 50.

In 1864 the flat amount was raised to $100, and in addition, it was provided that each company shall pay an income tax of two per centum on the gross amount of receipts from such occupation."[13] In 1870 there was levied on "every railroad, insurance, or telegraph company, doing business within this State, an annual tax of two per cent upon the gross receipts of same."[14] "From every agent or sub-agent of any insurance company, not chartered by this state, $50 and two per cent on gross receipts" were enacted.[15]

A return to the flat amount method was made in 1871, at which time the hitherto broad classification of "insurance companies" was broken down into two groups. On life insurance companies an annual occupation tax of $500 was levied, and on fire and marine companies, $250. It may be surmised that administrative facility was largely responsible for this return to a simple, proven method.[16]

Just why the distinction was made between life insurance companies on the one hand and fire and marine companies on the other is not known. Most states did not make such a distinction. Even today, Texas is in a distinct minority in having lower rates for fire companies. However, it is interesting to note that the separation into categories in the Texas law coincided with the great Chicago fire of 1871.

Apparently still searching for a more satisfactory base, the Legislature tried another device in 1873. The flat amount was allowed to remain the same for life companies, but an additional levy was required to be paid to each county in which the companies did business. The flat amount was lowered to $200 for fire and marine companies, but they, too, were assessed for each county.

Through the acts of 1889, insurance taxation remained substantially as it was in 1873. Changes in the flat amounts occurred from time to time, but these were not drastic. By 1889, they had come to be levies against the life companies in the amount of $300, plus $10 for each county, and levies

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[13] Acts 10th Leg., 2d C.S., 1865, ch. 11, p. 9.

[14] Acts 13th Leg., C.S., 1870, ch. 82, pp. 199, 216.

[15] Ibid., p. 200.

[16] Acts 14th Leg., R.S., 1871, ch. 52, p. 47.

against the fire, marine, and health companies of $200, plus $7 for each county.[17]

Present Pattern Established

The period of experimentation came to an end in 1893. At least, after that date the experimentation was confined within the structure of a gross premiums tax. The flat-amount approach, with its various auxiliary devices, was discarded. Moreover, Texas was in a much better position in 1893 to administer the gross premiums tax than it had been during the earlier periods. A state insurance department had been functioning for nearly 17 years, and there were no problems of post-war reconstruction or financial crisis to stand in the way.

Distrust of corporations had been growing for some time prior to this date, as evidenced by passage of the Sherman Anti-Trust Act in 1890. While there were no immediate financial crises, generally unsettled business conditions accentuated the unfriendly feeling toward the corporations. Certainly the depression which began in 1893 and lingered until 1898 did not relieve the feeling. At any rate, legislation directed at corporations during this era was likely to be received with public approbation. Reflecting this sentiment of the country, Texas Governor James S. Hogg had made his race for office on the platform of trust regulation. "Texas must rule the corporations or they will rule and ruin the people," he said.[18]

On January 25, 1893, Representative S. P. Mills of McLennan County introduced the bill which can be regarded as the beginning of our modern gross premium taxation. It was entitled "An act to fix the rate of taxation on insurance companies, telephone companies and other corporations. . . and to repeal all laws and parts of laws in conflict herewith."

The bill also provided in Section 5 for the first corporation franchise tax in Texas.

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[17] "At the beginning of this period, life, fire, and marine insurance companies were the only ones of the great modern corporations subject in this state to a special occupation tax. By the end of the period, however, and as a result of the tax measures adopted in 1879, not only were these companies, but gas, telegraph, express, sleeping and dining cars, and railroad companies were so taxable." E. T. Miller, A Financial History of Texas (Austin: University of Texas Bulletin No. 37, 1916), p. 217.

[18] Joseph L. Clark, A History of Texas (New York: D. C. Heath & Co., 1940), p. 356.

In the Senate, the Committee on Finance attached an amendment to reduce the tax by one-half to those companies which had one-half of their gross premium receipts (as distinguished from investment and other income) invested in Texas. Here struggling to be born was one of the provisions of the modern law -- the tax reducing investments -- but the birth was to be postponed until 1905.

After revisions by a free conference committee, the act passed both Houses and was approved by the Governor on May 11, 1893.

In its final form, it placed a tax of 1 and 1/4 per cent on gross premium receipts of life insurance companies from business within the state and 1/2 of one per cent on gross premium receipts of fire, marine, and other companies within the state.[19]

To follow the theme of distinguishing between the personal insurance companies and the property insurance companies, it is interesting to note at this point that the classes as we know them today were not set up in the 1893 act. This act did recognize two classes, but, by our present standards, they seem to be a rather hodge-podge assortment. It is to be noted that health and accident insurance, today classified with life insurance under the personal coverages was then placed in the fire and marine group.

Seemingly prevalent among political thinkers in many states at this period, particularly in states outside New England, was the idea that eastern insurance companies, especially life companies, were drawing the wealth out of these states in the form of insurance premiums. It was reasoned that these eastern companies made no investments in the other states and were thus not subjected to any property taxes. At the same time they were carrying on thriving businesses under the protection of local laws. It seemed only fair that they should bear some proportion of the expense of running the governments of the states from which they profited. Since the insurance taxes were accounting for approximately one-half of all revenues from occupation taxes during this period, it is understandable that considerable interest in insurance taxation was evident at the Capitol.[20]

A particular animosity was built up against New York, where a state law required insurance companies to invest at least 50 per cent of their reserves in that state.[21]

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[19] The other companies were "health, livestock guarantee or accident." Acts 23d Leg., R.S., 1893, ch. 102, p. 156.

[20] Miller, op. cit., p. 310.

[21] Reserves are the portion of a company's assets set aside to enable the organization to meet all claims on the insurance then in force and shown as a liability on the books of the company.

New York was regarded as somewhat of a financial vampire which was draining the life blood of the agricultural states. At least this was the analysis of the situation made in 1897 by Governor C. A. Culbertson, whose fame has come to rest on his vigor in tightening the anti-trust laws, collecting past-due taxes, and safeguarding labor.[22]

In a "condition of the State" address to the Legislature in 1897, he said:

> This drain might be more sufferable but for the fact that the money is squandered by the officials of the companies in the most scandalous salaries, perquisites and incidentals. The presidents of some of them receive higher salaries than the President of the United States. One of these, distinguished in rascality and driven from the presidency for unexampled venality, was afterward pensioned for life at the sum of $37,500 annually by his accomplices on the directorate.[23]

He went on to cite figures showing that the drain for the last ten years had totaled $13,696,555.34, which was more than the taxable values for the "great counties of Bell or Collin."

Following a specific recommendation of the Governor, the Legislature increased the tax on life insurance companies to two per cent, the rate on marine and other property insurance companies to one per cent and left the rate on fire companies at 1/2 of one per cent.[24]

Tax-reducing Investments and the Robertson Act

A small plug for the drain was fashioned in the tax of 1905. The idea of tax-reducing investments which had been proffered by the Senate in 1893 was brought out, dusted off, and made a part of the tax.

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[22] Clark, *op. cit.*, p. 356.

[23] House Journal, 25th Legislature, January 14, 1897, p. 22.

[24] Acts 25th Legislature, R. S. 1897, ch. 104, p. 140.

A tax of 2 and 1/4 per cent was placed on the life companies, but this could be reduced to 1/2 of one per cent or 1/4 of one per cent by investing respectively one-quarter or one-half of the company's entire assets in Texas securities or real estate. The rate on fire companies was increased to 1 and 3/4 per cent, and the rate on surety and guaranty companies to two per cent; but here again Texas investments were allowed to reduce the tax.[25]

The idea of requiring the foreign insurance company to make investments in the state was not entirely new. In fact, when California levied its first gross premiums tax in 1862, the tax was imposed only on foreign companies with less than $50,000 invested in California.

California was also having trouble with the "drain problem" at about the same time it was being considered in Texas, but it reached a different solution. As a result of the recommendations of a 1906 commission on revenue and taxation, California finally adopted in 1910 a constitutional amendment which permitted insurance companies, both foreign and domestic, to offset against the gross premiums tax the amount of any county and municipal taxes paid on real estate owned in California. This provision remained in the California constitution until it was repealed in 1943.

That the Texas tax-reducing investments scheme was workable is attested by the fact it has continued to be a part of the tax statutes down to the present day. While the provision is not found in the taxing statutes of most states, it is by no means unique and may be found with certain variations in the statutes of Colorado, Louisiana, Georgia, Idaho, and others.

But the real plug for the financial drain came in the form of the Robertson Act in 1907. It was the culmination of several years' efforts. In fact, a bill requiring compulsory investment of insurance company funds in Texas securities or real estate as fulfillment of the campaign promise of Governor Culbertson had been introduced as early as 1897 but had been defeated in the House after passing the Senate. The 1907 action came soon after the Armstrong investigations into the life insurance business in New York. The investigations had aroused a national hue-and-cry by their disclosures of graft, mismanagement, and the like.[26]

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[25] Acts 29th Leg., 1st C.S., 1905, p. 427.

[26] Magee, op. cit., p. 27.

The Robertson Act, named for Representative James H. Robertson, who introduced it, became law April 24, 1907. It provided:

> That all stock of mutual companies incorporated under the laws of this State or in any other State of the United States or any foreign country, for the purpose of doing a life insurance business in this State, invest and keep invested in Texas securities and in Texas real estate, as hereinafter provided, a sum of money equal to at least seventy-five per cent of the aggregate amount of the legal reserve set apart and apportioned to policies of life insurance written on the lives of citizens of this State.[27]

Whether there was actually a drain on Texas and whether the law operated for the benefit or the detriment of the Texas citizen and Texas financial interests was a subject of much bitter debate for years afterward.[28]

Whatever the right answer might have been, this much is known: Twenty-two life insurance companies stopped writing policies in Texas after the passage of the act, and ten of them have now returned to write policies under the act.[29]

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[27]Acts 30th Leg., R.S., 1907, ch. 170, p. 316, presently Tex. Civ. Stat. (Vernon, 1948) art. 4765 et. seq.

[28]For an answer to the "drain argument," see Locke and Locke, "Discussion Before the Texas Welfare Commission of the Robertson Insurance Act," 1912, p. 40, in which statistics are cited to show that there was no drain when properly analyzed or that, using the formula of Governor Culbertson, the drain was greater after the passage of this act.

[29]Many efforts have been made to repeal the Robertson Act. One bill with that intent was introduced in 1915 at the behest of Governor James E. Ferguson. Known as the Gibson Bill, it was defeated in the House after passing the Senate. A general referendum for repeal was defeated at the primary election of 1916. In 1925 the Wirtz Bill, another attempt at repeal, was defeated in the Senate after passing the House. Other futile attempts were made in 1925 and 1927. For an excellent collection of materials on the Robertson Act, see File 368.63, Texas State Library, Legislative Reference Division.

With the Robertson Act, which applied only to life insurance companies and was not itself a tax statute, and the changes made in 1909, the plan of gross premium taxation took on a final structural form. Thereafter for many years, the changes dealt chiefly with modification of the rates.

Prior to 1907, the rate on the fire and marine companies had been separate from that on casualty and surety companies. Since 1907, these two branches of insurance have received the same treatment in rates and other provisions. In the same year, the rate was increased to three per cent on life companies, subject to reduction by virtue of Texas investments.[30] In 1909 a distinction was between methods of taxing domestic and foreign life companies. Domestic life companies were relieved of the occupation tax; foreign life companies remained subject to the tax, which was modified depending upon tax-reducing investments.[31]

From 1909 to 1936, domestic life insurance companies were not required to pay the gross premiums tax. The foreign life insurance companies licensed to do business in Texas, like the domestics, were required to comply with the Robertson Act and invest at least 75 per cent of their legal reserves on account of Texas business in Texas investments. This 75 per cent, however, was not the same as that mentioned in the tax-reducing investments. The Robertson Act called for 75 per cent of the legal reserves on account of Texas business. The tax-reducing investments called for 75 per cent of the investments of the insurance company made in a state other than Texas where the insurance company had its greatest amount of funds invested. In many cases, 75 per cent of the Texas reserves would not quite equal 75 per cent of the company's investments made in the state of its highest investments.

One effect of the full basic rate of 3 per cent on foreign life companies during this period (1909-1936) was that it acted as a barrier to those companies which had withdrawn from Texas after passage of the Robertson Act. These companies were still collecting premiums on business written before their withdrawal. Each year the gross premiums tax, applied to these premiums, became an entry on the books of the Board of Insurance Commisioners against the day they should seek readmission to the state. When New York Life returned in 1947, after a 40-year absence, it paid $444, 265.46 in back taxes. (See Table Ins -- 1).

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[30] Acts 30th Leg., 1st C.S., 1907, p. 479.

[31] Acts 31st Leg., R.S., 1909, p. 192.

Table Ins -- 1

Companies Withdrawing from Texas During 1907, After Enactment of Robertson Law*

Name	Address	Returned to Texas	Tax Paid
Columbia National	Boston, Mass.		$
Des Moines Life	Des Moines, Iowa		
Equitable Life	New York, N. Y.	1937	405,980.97
Fidelity Mutual	Philadelphia, Pa.		
Germania Life (formerly Guardian Life)	New York, N. Y.	9-27-47	22,545.80
Home Life	New York, N. Y.	10-10-49	24,703.26
Manhattan Life	New York, N. Y.	1908	
Mass. Mutual Life	Springfield, Mass.	7-6-51	19,761.34
Metropolitan Life	New York, N. Y.	10-30-23	63,718.29
Mutual Benefit Life	Newark, N. J.		
Mutual Life of N. Y.	New York, N. Y.	9-1-50	211,000.00
National Life	Montpelier, Vt.		
New York Life	New York, N. Y.	9-4-47	444,265.46
Northwestern Mutual	Milwaukee, Wis.		
Penn Mutual	Philadelphia, Pa.		
Prudential	Newark, N. J.	1928	86,283.60
Reliance Life	Pittsburgh, Pa.	1909	
Security Mutual	Binghampton, N. Y.		
Travelers Ins. Co.	Hartford, Conn.	1922	16,584.83
Union Mutual	Portland, Maine	3-29-48	6,421.04
Washington Life	New York, N. Y.		
Wisconsin Life	Madison, Wis.		
		As of 7-6-51	$1,301,264.59

*In 1907 there were 47 life companies transacting business in Texas, and 22 life companies withdrew from Texas that year. Of that number, 12 have returned.

The Robertson Law became effective July 12, 1907.

Source: Manuscript prepared by the Board of Insurance Commissioners as of September 1, 1950.

The Robertson Act was challenged early in the case of Metropolitan Life Ins. Co. v. Love;[32] and this apparently was the only case in which the validity of the act has been questioned. The insurance company sought by its application a writ of mandamus to compel the Commissioner to issue it a permit to do business in Texas, alleging that it had fulfilled all the requisites except compliance with the Robertson Act and asserting that this was unnecessary because the act was unconstitutional and so invalid. The Supreme Court found that the Insurance Commissioner's duty to investigate the affairs of the applicant to the extent that he deems prudent was not merely a ministerial duty and that therefore mandamus could not be issued. The court's view of the facts was such that it found it unnecessary to discuss the company's assertions concerning the Robertson Act. Neither the opinion of the court nor the summary of the parties' briefs in the official reports indicate the basis for the attack upon the act.

In 1936, domestic life insurance companies were again made liable for the premiums tax at the rate of 1/2 of one per cent.[33]

It is interesting to note that the highest tax rates, both for the fire and casualty group and the life group, were made effective in 1941. That year the basic fire rate was 4.05 per cent with a possible reduction to 1 and 1/2 per cent or 3/4 of one per cent for respective investments of one-fourth and one-half of the entire assets of the company in Texas.[34] The basic rate for foreign life companies was 4.65 per cent with deduction steps to 4.05, 3.6, and 3.1 per cent for investments of 30, 60, and 75 per cent of the company's Texas reserves in Texas securities. Domestic life rates were increased slightly to 5/8 of one per cent.

After 1941, no changes occurred until 1945, at which time the gross premiums tax structure underwent some major alterations. Two opinions of the Supreme Court of the United States -- U. S. v. South-Eastern Underwriters Ass'n.[35] and Polish National Alliance v. Labor Board[36] --handed down in June 1944 were the moving causes in these changes.

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[32] 101 Tex. 444, 108 S.W. 821 (1908).

[33] Acts 44th Leg., 3d C.S., 1936, ch. 495, art. IV, p. 2075.

[34] Acts 47th Leg., R.S., 1941, ch. 184, art. XVIII.

[35] 322 U. S. 533 (1944).

[36] 322 U. S. 643 (1944).

Insurance as Commerce

In the 75 years since Paul v. Virginia,[37] the belief had become firmly established that insurance was not within the reach of Congress and not within the purview of the Commerce Clause of the federal constitution. Mr. Justice Field declared that "Issuing a policy of insurance is not a transaction of Commerce."[38] If the insurance business was not commerce, it then could not be interstate commerce. However, an abrupt change occurred when the court delivered its opinions in U. S. v. South-Eastern Underwriters Ass'n. and Polish National Alliance v. National Labor Relations Board. These two decisions opened the door to federal regulation of the insurance business and cast a cloud on state regulation and certain state taxation. "Perhaps it would be more accurate to say that these two decisions merely tore away an illusory veil from a door that was open all the time."[39] It was widely felt that a stunning, though not entirely unexpected, blow to the insurance profession had been struck.

Beginning with the Paul case, a series of "insurance cases," as they became known to students of constitutional law, found their way to the Supreme Court. Because these cases may be of assistance in understanding past legislation and the current situation, it may be appropriate to review some of them briefly.

In the Paul case, Paul, a citizen of Virginia, was indicted for selling insurance for a foreign company without a license. The license had been denied him because the New York company which Paul represented refused to deposit certain securities in compliance with Virginia statutes. Paul contended, inter alia, that insurance was commerce, that his activity was interstate commerce, that Virginia's statutes amounted to regulation of interstate commerce, and that this was forbidden by the federal constitution. The court held that the Virginia statutes were not in conflict with the federal constitution. Mr. Justice Field declared for the court:

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[37] 8 Wall. 168 (1869)

[38] Ibid.

[39] Patterson, The Future of State Supervision of Insurance, 23 Tex. L. Rev. 18, 19 (1944). This article contains a penetrating review of the problems posed by these two decisions.

> Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the insured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. They are not subjects of trade and barter offered in the market as something having an existence and value independent of the parties to them. They are not commodities to be shipped or forwarded from one State to another, and then put up for sale. They are like other personal contracts between parties which are completed by their signature and the transfer of the consideration. Such contracts are not inter-state transactions, though the parties may be domiciled in different States. The policies do not take effect -- are not executed contracts -- until delivered by the agent in Virginia. They are, then, local transactions, and are governed by local law. They do not constitute a part of the commerce between States. . . .[40]

State regulation having been tested in the Paul case, the right of a state to tax insurance business done within the state by an out-state company was raised in New York Life Insurance Company v. Deer Lodge County.[41] Montana law required insurance companies to pay a tax to the county based upon the excess of premiums collected therein over losses and ordinary expenses incurred therein during the year. The insurance company, with home offices in New York, brought an action to recover the tax paid under protest, contending that the company's activities constituted interstate commerce; that the tax was a burden thereon and therefore invalid as contrary to the Commerce Clause of the Federal Constitution. The court carefully reviewed its six insurance cases since the Paul case, involving several different kinds of insurance, and concluded, "The decision of the cases is that contracts of insurance are not commerce at all, neither state nor interstate."[42] Thus, the Montana tax was held valid.

It is very important to notice that the "insurance cases" had all been concerned with the efforts of the states to regulate and tax insurance companies. The question had never been asked, "Can the federal govern-

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[40] Paul v. Virginia, 8 Wall. 168, 183 (1869)

[41] 231 U.S. 495 (1913).

[42] Ibid., p. 510.

ment regulate and tax them?" The decisions had held that the states could do this because the business of insurance was not commerce, or at the most not interstate commerce. From this it was deduced that the insurance business could not be regulated and controlled by the federal government.

The Missouri Rate Cases

The precipitant which brought about the investigations that ultimately led to the federal anti-trust suit against the South-Eastern Underwriters Association was an insurance fraud in Missouri. The cases resulting from this fraud are now referred to as the "Missouri Rate Cases." The leading character in these cases was Thomas J. Pendergast, and he led the other characters to the federal penitentiary.

In the fraud, 139 insurance companies had instituted the same number of injunction suits against the Superintendent of Insurance and the Attorney General to restrain enforcement of an order made by the Superintendent of Insurance fixing fire insurance rates. The companies contended that the rates were confiscatory. The court permitted the collection of the higher rates pending the trial but impounded the excess. This deposit was $10,000,000 at the time of the fraud. Through the machinations of Pendergast, the Superintendent of Insurance and the insurance companies entered into "a pretended or fake settlement of the suits, whereby the interest of policyholders would be sacrificed and 80 per cent of the impounded fund would be paid to the companies." The fake settlement was presented to the court which, deceived into thinking it an adversary settlement made in good faith, approved it. Pendergast and the others received large sums from the insurance conspiracy which they failed to report for income tax.

For awhile the goose hung high. Then "seemingly insignificant and unrelated facts" led the United States Attorney for the Western District into an investigation which uncovered the whole escapade.[43]

For years prior to the Missouri cases, numerous organizations and conferences of insurance companies combined to fix rates. Admittedly, this was a practice not permitted by the Sherman Act, but it was thought insurance companies were not subject to the act.[44] After the Missouri cases, the United States Attorney General appointed a

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[43]28 F. Supp. 602 (1939). For the full history of the fraud and its effect upon the insurance litigation, see American Insurance Company v. Lucas, 38 F. Supp. 896, 926, (1941); also, 34 F Supp. 269 (1940); Pendergast v. United States, 317 U.S. 412(1943).

[44]Appleman, Insurance Law and Practice (1946) 269, sec. 10581.

special assistant to look into the possibility of anti-trust violation. Upon receiving and considering his report, the Attorney General decided to prosecute one of the offenders. United States v. South-Eastern Underwriters Association resulted from this decision.[45]

The South-Eastern Underwriters Association (SEUA) and its membership of 198 stock fire insurance companies and 27 individuals were indicted under the Sherman Anti-Trust Act. The indictment alleged two conspiracies: (1) to restrain interstate trade and commerce by fixing arbitrary non-competitive premium rates and (2) to monopolize trade and commerce among six southeastern states. The indictment charged that the SEUA controlled 90 per cent of the fire and allied lines in Florida, Georgia, North Carolina, South Carolina, and Virginia; fixed premium rates; and employed boycotts, coercion, and intimidation to force non-member insurance companies into the conspiracy and compel agents not to represent non-members.

The district court sustained SEAU's demurrer to the indictment on the ground that "the business of fire insurance is not commerce, either intrastate or interstate" and that therefore it was not subject to the prohibitions of the Sherman Act. On appeal, the Supreme Court held, with Chief Justice Stone and Justices Frankfurter and Jackson dissenting, that the judgment sustaining the demurrer should be reversed.[46] That this case had attracted wide public interest is attested by the fact that 35 states, not including Texas, had filed amicus curiae briefs; they argued for a position contrary to that subsequently adopted by the court.

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[45] 322 U.S. 533 (1944).

[46] In a case dealing with the same general problem and handed down the same day, Polish National Alliance v. National Labor Relations Board, 322 U.S. 643 (1944), the Supreme Court held that the National Labor Relations Act did apply to alleged unfair labor practices of a fraternal benefit society engaged in the making of life, accident, and health insurance contracts across state lines and that such application was within Congress' power under the Commerce Clause. Mr. Justice Frankfurter for the court found that the society's conduct affected interstate commerce and upon that ground could be regulated by Congress. Mr. Justice Black, joined by Justices Douglas and Murphy, concurred, contending, however, that the society's activities were commerce and did not merely "affect commerce."

Mr. Justice Black writing for a majority of the court in a 25-page opinion crammed with footnotes, reviewed the history of the insurance business and constitutional law. The court's opinion concluded that the insurance business carried on by the defendants was commerce and that Congress did not intend to exempt the insurance business from the bans of the Sherman Act. At pages 539-540, he viewed the imposing position of insurance in the national economy:

> The modern insurance business holds a commanding position in the trade and commerce of our Nation: Built upon the sale of contracts of indemnity, it has become one of the largest and most important branches of commerce. Its total assets exceed $37,000,000,000, or the approximate equivalent of the value of all farm lands and buildings in the United States. Its annual premium receipts exceed $6,000,000,000, more than the average revenue receipts of the United States Government during the last decade. . . Insurance touches the home, the family, and the occupation or the business of almost every person in the United States.

Upon examining the interstate commerce arguments, Justice Black said the entire insurance transaction, not merely the insurance contract, should be examined:

> We may grant that a contract of insurance, considered as a thing apart from negotiation and execution, does not in itself constitute interstate commerce. . . But it does not follow that the Court is powerless to examine the entire transaction, of which the contract is but a part, in order to determine whether there may be a chain of events which becomes interstate commerce.
>
> Only by treating the Congressional power over commerce as a "technical legal conception" rather than as a "practical one, drawn from the course of business" could such a conclusion be reached. In short, a nationwide business is not deprived of its interstate character merely because it is built upon sales contracts which are local in nature. Were the rule otherwise, few businesses could be said to be engaged in interstate commerce. [47]

[47] 322 U.S. 533, 546-547 (1944).

Chief Justice Stone in his dissent conceded that the modern insurance business had interstate manifestations which afford the basis for federal regulation but contended that such regulation must be based on the premise that it was regulation of activities affecting commerce and not a regulation of commerce because insurance has long been declared not to be commerce. He further stated that the facts demonstrated that Congress did not intend that the Sherman Act should apply to the insurance business. Mr. Justice Jackson took the position that modern insurance business, as usually conducted, is in fact commerce, and where conducted across state lines is in fact interstate commerce; however, insurance has acquired an established doctrinal status not based on current facts; for constitutional purposes a fiction has been established, and long acted upon by the court, the states, and Congress, that insurance is not commerce; and that so long as Congress acquiesces, the court should adhere to the doctrine. He maintained that such an approach would permit Congress to regulate at some future date should it wish but would remove a cloud from present state regulation and taxation.

The minority of the court, in its concern over the impact of the decision, echoed the sentiments of the court in the Deer Lodge case, where the insurance company took a position contrary to that taken by the companies in the case under consideration. Mr. Chief Justice Stone prophetically raised the questions of the impact of the court's decision in the following statement:

> Its (Supreme Court) action in now overturning the precedents of seventy-five years governing a business of such volume and of such wide ramifications, cannot fail to be the occasion for loosing a flood of litigation and of legislation, state and national, in order to establish a new boundary between state and national power, raising questions which cannot be answered for years to come, during which a great business and the regulatory officers of every state must be harassed by all the doubts and difficulties inseparable from a realignment of the distribution of power in our federal system. [48]

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[48] Ibid., p. 583.

Mr. Justice Jackson considered the majority opinion to be erroneous policy:

> The Court's decision at very least will require an extensive overhauling of state legislation relating to taxation and supervision. The whole legal basis will have to be reconsidered. What will be irretrievably lost and what may be salvaged no one now can say, and it will take a generation of litigation to determine. Certainly the states lose very important controls and very considerable revenues. The recklessness of such a course is emphasized when we consider that Congress has not one line of legislation deliberately designed to take over federal responsibility for this important and complicated enterprise.[49]

The McCarran Act

In 1943, when the United States appealed from the decision of the district court, alarm was spread in the insurance world. On September 20 of that year, companion bills were introduced in Congress, the Walter-Hancock Bill in the House and the Baily-Van Nuys Bill in the Senate. These would have exempted insurance from all federal control, including the anti-trust acts. The House passed its bill, but the Senate balked. After much negotiation, a compromise measure, the McCarran Act, carrying the approval of the state insurance commissioners and the insurance companies, was passed as Public Law 15. Entitled "An Act to Express the Intent of the Congress with Reference to the Regulation of the Business of Insurance," it was approved by the president on March 9, 1945.

Summarized, it provides:

(a) Regulation and taxation by the states of the business of insurance is in the public interest; and silence of Congress shall be no barrier.

(b) The business shall be subject to state laws which regulate and tax it.

(c) No act of Congress, unless it refer specifically to insurance, shall invalidate any such state law: Provided that after January 1, 1947 (later extended to June 30, 1948), the Sherman Act, the Clayton Act, and the Federal Trade Commission Act shall be applicable to insurance to the extent that insurance is not regulated by the state law.

[49] Ibid., p. 590.

(d) Until January 1, 1947 (later extended to June 30, 1948), the aforesaid acts and the Robinson-Patman Act shall not apply to insurance.

(e) The Sherman Act shall continue to apply to boycott, coercion, and intimidation.

(f) This Act shall not affect the application of the National Labor Relations Act, the Fair Labor Standards Act, or the Merchant Marine Act of 1920. [50]

The fright occasioned by the SEUA decision was not completely allayed by the passage of Public Law 15. Many states, including Texas, were fearful that their taxing statutes would be held unconstitutional as an undue interference with interstate commerce and proceeded forthwith to put their houses in order. Retaliatory provisions fell from the taxing statutes like autumn leaves in many states. Texas was no exception. Provisions which had avowedly discriminated against foreign companies from their very inception were repealed and re-enacted in such form that no discrimination remained.

But while many states were frantically overhauling their tax structures to accord with the new Supreme Court view, others remained dauntless and even retained their retaliatory provisions. [51]

Prior to the 1945 change in Texas, the domestic life insurance companies were taxed at the rate of 5/8 of one per cent, while foreign life companies were being taxed at the basic rate of 4.65 per cent. In the 1945 change, domestic and foreign life companies were placed on the same basis. [52] Both were taxed at the rate of 3.5 per cent, and for the first time since 1909, the schedule of tax-reducing investments was made the same for both. This schedule permitted the company to reduce its tax to as little as .95 of one per cent of the amount it had invested in the state honored by its maximum investments.

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[50] This summary is borrowed from Lilly, Insurance as Commerce - Five Years Under the SEUA Decision (1950), Maryland Law Review 81. The act, however, is short and is sectionized in like manner.

[51] For a succinct description of the effect of the SEUA case, see CCH, State Tax Guide, p. 2011.
Confirmation of the fact that the overhauling of the Texas statutes in 1945 was due to the SEUA case was obtained from an oral interview with William J. R. King, author of Texas Laws on Insurance (1949), who was on the Texas Attorney General's Staff at the time this legislation was recommended.

[52] Acts 49th Leg., R.S., 1945, ch. 279, p. 442.

There had never been any distinction between foreign and domestic fire and casualty companies, but, nevertheless, the tax statute was modified in respect to the tax-reducing investments for such companies. Prior to 1945, this schedule had been based on the percentage of "its entire assets" which the company had invested in Texas real estate and securities.[53]

After the 1945 act, the tax-reducing investment schedule was based on a percentage of "the amount that it had invested in similar securities in the state in which it had its highest percentage of admitted assets invested." If the company should invest in Texas as much as 90 per cent of the highest amount it had invested in any other state, its tax would be reduced from the basic rate of 3.5 per cent to one per cent.[54]

On the national scene, after the passage of Public Law 15, the State Insurance Commissioners, the insurance industry, and the Insurance Section of the American Bar Association worked together feverishly to turn out proposed state legislation which would be acceptable to the various interests involved and still act as a shield against federal anti-trust laws. There were wheels within wheels and committees within committees, but the All-Industry Committee was the chief mover.[55]

This committee produced suggested rate law legislation which has now been adopted in all states.

The full meaning of the South-Eastern Underwriters case and the McCarran Act and the status of state insurance taxation and regulation was not clear. Considerable comfort was given to the states by the Supreme Court in Prudential Insurance Co. v. Benjamin,[56] in which the court sustained a South Carolina tax which discriminated against out-state insurance companies. South Carolina imposed a three per cent tax, with a tax-reducing investments provision, based upon gross premium returns from the state. South Carolina insurance companies were totally exempt from the tax. Prudential, a New Jersey Corporation, having paid the tax for years, reneged shortly after the South-Eastern Underwriters case and brought action in the state Supreme Court contesting the validity of the tax. Prudential argued that, since the tax was levied without regard to its interstate or local character and since domestic companies were exempt, the tax was invalid because it discriminated against interstate commerce. On appeal, the Supreme Court sustained the tax. Conceding that the South Carolina tax discriminated against interstate commerce in insurance and so generally would be invalid, the unanimous court decision declared that the tax is valid because Congress, through the McCarran Act, has consented to such discrimination by way of state taxation and that such consent is constitutional. From this case one writer concluded: "The prohibition

53 Acts 47th Leg., R.S., 1941, ch. 184, art. 18, sec. 1, p. 269.
54 Acts 49th Leg., R.S., 1945, ch. 341, p. 574.
55 Lilly, op. cit., p. 92.
56 328 U.S. 408 (1946).

against state legislation discriminating against interstate commerce seems, then, to be Congressional, not constitutional. . . ." [57]

When it is remembered that this case involved a state tax which discriminated against foreign insurance companies, it seems that the Benjamin case goes a long way toward establishing a firm foundation for any state taxation and regulation. [58] For the time being -- at least so long as the McCarran Act remains unchanged -- state taxation and regulation of the insurance business seems secure. [59] Ten states including Texas, filed briefs, as amici curiae, in support of the South Carolina Tax in the Benjamin case.

Distinction Again Applied to Foreign Companies

After the "fright amendments" of 1945, the taxing articles remained quiescent until 1949. Presumably by that time the reassuring effect of Prudential Insurance Company v. Benjamin[60] had been felt because Texas then undid what it had done in 1945. It renewed its distinction between domestic and foreign life, accident, and health companies. Article 4679a, [61] which had combined the two, was repealed insofar as it applied to domestic companies by Article 7064a and insofar as it applied to foreign companies by Article 4769. The effect of this revision was to place a flat one-per-cent rate on the domestic life, accident, and health companies and a basic rate of three per cent on foreign companies. However, the foreign companies have the right to reduce the tax by making tax-reducing investments. They may lower the rate in this way to as little as 1.75 per cent for investments of more than 90 per cent of the amount they have invested in the state of their highest investment.

Another feature of the 1949 revision made Mexican casualty companies writing business in Texas to cover insureds while in the Republic of Mexico subject to the same gross premiums (and other) taxes as other casualty companies. [62]

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[57] 46 Col. L. Rev. 882 (1946).

[58] Another case decided at the same term of court in favor of state regulation did not rely on the McCarran Act. It involved criminal action against an agent who was soliciting for an Arizona insurance corporation for not having obtained a license in the State of California. The Arizona company was not licensed in California and was selling by radio. The California licensing law was upheld. Robertson v. California, 328 U. S. 408 (1946).

[59] See "Congress and Federal Regulation of Insurance" by Senator Pat McCarran, Proceedings of Section of Insurance Law, St. Louis: American Bar Association, (1949), p. 233.

[60] 328 U. S. 408 (1946).

[61] Tex. Civ. Stat. (Vernon, 1948).

[62] Acts 51st Leg., R. S., 1949, ch. 551, sec. 1, p. 1067; Tex. Rev. Civ. Stat. Ann. (Vernon, 1949), art. 5012a.

In 1950, as a part of the omnibus tax bill, additional taxes were imposed on all insurance companies subject to the tax to the extent of ten per cent of 3/4 of the normal taxes due for 1950 and ten per cent of 2/3 of the normal taxes due for 1951.[63] This temporary increase became permanent in 1951, and the new rates will be explained in detail later.

Summary of Historical Development

In Texas, insurance companies have been subject to the ad valorem tax from the very earliest days. By 1862, it became apparent that this tax was not thoroughly suited to insurance companies. This might have been due to a number of things. It was difficult to assess the intangible assets of the insurance companies, and the stocks and bonds which comprised most of the property of the companies could be quickly and easily transferred in and out of the state, as tax advantages might be gained.

Another consideration militating against the property tax, in principle at least, was that the insurance companies' reserves were actually being held in trust for the policyholders. In theory, to tax the reserves and again tax the policyholder on the basis of its surrender value, which was theoretically possible, would be taxing the same thing twice. Of course, this argument was mostly theory because neither the company nor the policyholder bothered to render this personal property in most instances. Operating solely under the property tax scheme, the states could not, by the simple device of raising the property tax rates on insurance companies, obtain additional revenue from them because of the constitutional provisions requiring equality and uniformity of taxation.

All in all, to obtain a revenue commensurate with profit-acquiring proclivities within the state, it was an inescapable conclusion that some different tax should be imposed upon the company.

When the fiscal planners started casting about for a tax to fulfill their needs, they found numerous examples of insurance taxes in other states. Even at that time, most of the states were levying gross premiums taxes, but the disorganized conditions in Texas after the Civil War made the gross premiums tax difficult to administer. For most of the early period, the state had to be satisfied with an exaction based on a flat amount.

A flat amount obviously was not a fair tax on all companies. More important, it did not gather for the state the potential maximum taxes inherent in the insurance operation. Thus, in 1893, the gross premiums tax in substantially its present form was enacted. Because it made no distinction between foreign and domestic insurance companies, the 1893 tax may be regarded as essentially a

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[63] Acts 51st Leg., 1st C. S., 1950, ch. 2, art. XVII, secs.1-3.

revenue measure rather than one concerned with regulation. In this respect, it differed from most state taxes of that time because they had been motivated by a desire to discriminate against foreign companies. It should be noted that Texas has never felt it necessary to discriminate against the foreign companies in the property insurance field. Considering that the original taxes were designed by other states to discriminate against the fire insurance companies chartered outside their boundaries, the Texas tax was even more exceptional.

With passage of the Robertson Act in 1907, however, a distinction was made against the foreign life insurance companies. With one brief interruption from 1945 to 1949 produced by the SEUA case, the distinction has continued to the present.

For some unexplained reason, Texas has always applied different rates to the life and personal companies and the fire, marine, and property companies. Many changes have been made in these classifications, and companies which were associated with the property group in the early days are now found with the life group. A meticulous tracing of these changes is well-nigh impossible and would not be of any great value. The classifications in the Texas act today follow the lines of classifications made generally in the insurance industry.

The enactment of an Insurance Code and a Driver's Responsibility Law in 1951 will undoubtedly have some effect upon the gross premiums tax in the years to come. The Driver's Responsibility Law is particularly expected to provide additional tax revenue.[64]

64 Acts 52d Leg., R.S., 1951, ch. 491 and ch. 498, p. 1210.

SECTION 2 - ORGANIZATIONAL FORM

The collection of the gross premiums tax and the administration of the laws pertaining to it are placed by the statutes in the hands of the Board of Insurance Commissioners. Actually, the whole function is centered in the office of the Chairman of the Board (the Life Insurance Commissioner); the other two commissioners devote their attention to other matters.

This centering of the responsibility on the Life Insurance Commissioner is in keeping with the over-all scheme of organization for the board in that the chairman is assigned the task of handling those problems common to all types of companies and not peculiar to any one of the divisions of life, fire, or casualty.

If the collection of 12 or 13 million dollars per year can be said to be incidental, it might be said the handling of the gross premiums tax is an incidental function of the Board of Insurance Commissioners. In this respect, the gross premiums tax stands in a unique position among other important revenue-producers of the state. In most cases, tax-gathering machinery has been established and operated primarily to bring in revenue. Here, however, a large state department, set up to control one of the most extensive and complicated industries in the state -- controlling exclusively, it might be added, without the aid of any federal assistance -- is given the additional job of collecting a tax from that industry.

Because of this situation, the board knows the industry with which it deals, perhaps to a greater extent and certainly in far greater detail, than most other tax-gathering agencies in the state. In fact, it has detailed data on every insurance company doing business in the state for every year that business has been done. This information is contained in the Annual Statements sent to the board by each company. These contain every detail which bears on the operation of the company and particularly on any question of its solvency. Because the board has this information, because it is set up to audit this information and get it anew from year to year, and because the companies must submit these data to continue in business, the tax-collecting organization is relieved at the outset of many of the problems ordinarily encountered in handling a tax, and particularly of the problem of coverage.

This, then, explains how it may be said that collection of the tax is an incidental function of the Board of Insurance Commissioners. Indeed, only two employees of the board have as their full-time work the handling of the tax. These are the Tax and Deposit Supervisor and one assistant. The work involved in carrying out the administration of the tax, however, spreads across departmental lines and comes in contact with many other officials and individuals, some only distantly related to the tax-collecting function.

As already mentioned, the Life Insurance Commissioner is the organizational head of the tax administration. Under him is the Tax and Deposit Supervisor with one assistant. When the tax returns and remittances are received, the supervisor transmits the collections to the State Treasurer through the bookkeeping section of the board. When questions arise in connection with a particular return, the supervisor takes them up with other officials. If they simply call for technical advice, they will be taken up with the chief clerk of the board (when they relate to fire and casualty companies) or the actuary (when they relate to life insurance companies); the legal examiner of the board may be called in on occasion. When the questions involve legal interpretation, they are referred to the Attorney General for an opinion. The auditing of the statement is carried out in two operations. One is performed by the supervisor at the time the return is received. The other is made in the field when the insurance company is given its periodic examination. This latter audit is carried on by the field examiners under the direction of the chief clerk.[65] Often it involves co-operation with the auditing division of another state. For example, a Texas examiner may participate in an examination being made in New York by the insurance board of that state. Or, occasionally, an investigation made by the examiners of another state will be accepted by Texas under a reciprocal arrangement worked out under auspices of the National Association of Insurance Commissioners.

Some broad policy matters may at times be decided by the Life Insurance Commissioner.

Thus, while only two employees spend full time on the tax, many others, both in and out of the office of the Life Commissioner, have a hand in the administration of the taxing laws. Many questions of discrepancy or error in tax returns are handled directly with the companies involved by correspondence. The history of relations with companies shows no cases where resistance was encountered or where settlement of differences necessitated legal action.

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65 Tex. Civ. Stat. (Vernon, 1948) art. 4680.

SECTION 3 - ASSESSMENT

General

The tax on insurance companies is levied on a specified group of such companies doing business in the fields of personal or property insurance. Although often classified as a gross receipts tax, the basis of the tax is the amount of gross premiums collected by the company, not the gross receipts. Different rate schedules apply to personal and property insurance premiums and to domestic and foreign companies. The tax is computed by the taxpayer and paid at the time annual company statements are submitted. On these are based authority to do business in the state. Only a negligible amount of litigation on the tax is recorded during the nearly 60 years of its operation. A company liable for the gross premiums tax is not subject to any others except certain maintenance taxes collected to defray expenses of the Board of Insurance Commissioners, ad valorem taxes, and unemployment compensation taxes. However, an occupation tax, which may be considered an additional one,[66] is levied on insurance adjusters and general agents of insurance companies.

In spite of the apparent simplicity of the assessment feature of this tax, several classifications of exemptions, an involved schedule of tax-reduction based on specified types of investments, and a series of maintenance taxes complicate the assessment procedure considerably and raise a number of questions , both of policy and practice.

Classifications and Exemptions

The classifications are uniform and broad enough to cover all insurance companies except those specifically exempted. Principal exemptions are of fraternal benefit associations and non-profit mutual aid organizations.

In the property insurance group, these organizations are included:

> Every insurance corporation, Lloyd's or reciprocals, and any other organization or concern transacting the business of fire, marine, marine inland, accident, credit, title, livestock, fidelity, guaranty, surety, casualty, workmen's compensation, employers' liability, or any other kind or character of insurance business. . .

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66 Tex. Civ. Stat. (Vernon, 1948) art. 7047, secs. 10a and b. See discussion in Staff Research Report No. 52-2, A Survey of Taxation in Texas: Part II-B, "Miscellaneous Taxes and Fees."

. . . Purely co-operative or mutual fire insurance companies carried on by the members thereof solely for the protection of their own property, and not for profit. . .

In the personal insurance group, two statutes are used to define the classifications.[67] The first applies to domestic companies and includes the following:

Every group of individuals, society, association, or corporation (all of which shall be deemed included in the term "insurance organization" whenever used in this Act) organized under the laws of this State and transacting the business of life insurance, personal accident insurance, life and accident insurance, or health and accident insurance for profit, or for mutual benefit, or protection in this State. . .

These are excluded from this group:

. . . local mutual aid associations, fraternal benefit societies, and fraternal insurance associations or societies that limit their membership to one (1) occupation. . .

The next statute[68] taxes the foreign personal insurance companies and includes:

Every group of individuals, society, association, or corporation (all of which shall be deemed to be included in the term "insurance organization" whenever used in this Act) not organized under the laws of this State and transacting the business of life insurance, personal accident insurance, life and accident insurance, or health and accident protection in this State. . .

Excluded from this group are the following:

. . . local mutual aid associations, fraternal benefit societies, and fraternal insurance associations or societies that limit their membership to one (1) occupation. . .

It is evident that in each of the categories of insurance business against which the gross premiums tax is levied, certain types of organizations writing insurance are exempted from the tax. Outstanding among these are the burial

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67 Tex. Civ. Stat. Ann. (Vernon, 1948) art. 7064a.

68 Tex. Civ. Stat. (Vernon, 1948) art. 4769.

associations which operate widely in the state. Their exemption comes under the clause exempting "local mutual aid associations," as they are usually organized under Article 4875a (Vernon's Texas Civil Statutes). More than 400 such burial associations have been operating in recent years, and their annual premium income volume has at times approached four million dollars. (See Table Ins. - 4).

Another exemption that removes a large amount of premiums from the reach of the tax is that of the "fraternal benefit societies, and fraternal insurance associations or societies." Although slightly fewer than 50 are currently writing insurance in the state, their annual premium income has averaged more than eight million dollars annually in recent years.

In the field of property insurance, the sizable exemptions are the county mutuals, organized under Article 4860a-20 (Vernon's Texas Civil Statutes).[69]

The question has been raised in several quarters as to whether the intent of the Legislature in exempting fraternal associations and certain mutual assessment organizations may not have been distorted in many cases by organizations actually operating for profit and to the pecuniary advantage of a few individuals rather than the collective welfare of the group, as originally intended. Some of these groups, it is claimed, are in direct competition with the insurance companies which pay the tax. This is a phase of the national problem of tax exemptions for co-operatives.

In recent years the question has been widely raised whether the modern nature of co-operatives justifies their being distinguished from ordinary corporations so as to grant them special tax treatment. The discussion has centered principally around the federal income tax exemptions granted co-operatives.[70]

Basis - Exceptions and Deductions

The basis of the tax is the amount of gross premiums collected on risks in Texas. There are, however, certain exceptions and deductions.

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[69] Ibid., art. 4905c; Acts 49th Leg., R. S. 1945, ch. 161, sec. 4, p. 214.

[70] Magill and Merrill, The Taxable Income of Coöperatives, 49 Mich. L. Rev. 167 (1950) and Paul, The Justifiability of the Policy of Exempting Farmers' Marketing and Purchasing Cooperative Organizations from Federal Income Taxes, 29 Minn. L. Rev. 343 (1945) contain a good statement of this argument.

In the case of domestic personal insurance coverages (life, accident, health, etc.), the tax is not applicable to the first-year premiums of policies; premiums returned are deductible; premiums waived under disability and payor benefit agreements are deductible; considerations for annuities are deductible; and dividends to policyholders are deductible. The amount of examination and valuation fees paid by the company for the use of the state is allowed as a credit against the amount of the tax, and premiums received from other licensed insurance companies for re-insurances are excluded. Premiums paid by the company for re-insurance are not deductible.

The first-named of these exemptions, that which excludes the first-year premiums from the tax, was created largely because of the insurance business practice of paying a large portion of these premiums to salesmen. Significantly, this exemption has in recent years benefited a type of insurance which probably was not anticipated when it was established and hence may not come within the reasons for the exemption. The companies especially benefited by this provision have been those writing insurance in connection with the personal loan business. A loan company will require this coverage on the borrower, ostensibly to secure the loan in the event of sickness or death. Actually, there have been indications that this coverage has often been used to collect a profit on loans in excess of that allowed by the usury laws. The loan usually will be made for less than a year, so that the premium will be excluded from the gross premiums tax. In such cases, the borrower is required to buy "credit insurance," i. e. health, accident, and life insurance having high premiums and having few benefits. The loan company, designated the beneficiary of the policy, either owns the insurance company or, as its agent, gets from 75 to 90 per cent of the premiums collected. The scheme has been described as "strictly a means of circumventing the ten per cent per annum interest maximum prescribed by law."[71]

> . . . The loan shark. . . disguises the true nature of his charges by various subterfuges, such as life and health insurance at an exhorbitant premium, most or all of which is retained by the lender as his commission.[72]

In the case of the foreign personal insurance companies, the deductions, credits, and exclusions are the same as for the domestics.

In the case of property insurance companies, (fire, casualty, and surety, etc.) the tax is based on

> the total gross amount of premiums received on each and every kind of insurance or risk written, except premiums received from other licensed companies for reinsurance, less return premiums and dividends paid policyholders, but there shall be no deduction for premiums paid for reinsurance.

71 J. W. Goode Jr., Harrassing the Loan Shark, 14 Tex. B. J. 113, 114-115(1951).
72 C. A. Guittard, Lawyer v. Loan Shark, 14 Tex. B. J. 109 (1951).

Rate and Tax-Reducing Investment Feature

The basic tax rate for the property insurance companies is 3.85 per cent of the gross premiums received on property or risks located in this state.

A company may reduce this rate, however, by making investments in "Texas securities" to the extent of 75 per cent or more of the highest amount it has invested in any other state. Such investments will reduce the tax as follows:

When the Texas investments are:

Not less than	and not more than	the tax rate is
75%	80%	3.025%
In excess of		
80	85	2.75
85	88	2.20
88	90	1.65
90	--	1.10

The act defines the following as Texas securities:

(1) Real estate in this State.
(2) Bonds of the State of Texas.
(3) Bonds and interest-bearing warrants of any county, city, town, school district, or any municipality or subdivision thereof.
(4) Notes or bonds secured by mortgage and deed of trust on property in this State insured by the F. H. A.
(5) Cash deposits in banks and trust companies in this State.
(6) Percentage of investments in U. S. bonds equal to the percentage of reserves required under Texas law to the company's total reserves.
(7) Any other property in this state in which insurance companies may invest their funds.

In the case of domestic personal insurance companies, the rate is 1.1 per cent of the gross amount of premiums collected during the taxable year from persons residing or domiciled in Texas.

There is no schedule of tax-reducing investments for this group of companies, but if a company has less than $450,000 premiums from all sources, it is required to pay only 55/80 of one per cent of the gross amount of premiums collected during the year from persons residing or domiciled in Texas.

In the case of the foreign companies writing personal insurance, the basic rate is 3.3 per cent of the gross amount of premiums collected during the taxable year from persons residing or domiciled in Texas.

While this rate is considerably higher than that of the domestic companies writing life, accident, health, and other personal coverages, it is subject to certain reductions for Texas investments. These investments are based on a percentage of the amount the company has invested in the state other than Texas where it has the highest amount of reserves invested.

When the Texas Investments are:

More than	and not more than	the tax rate is
75%	80%	3.025
80	85	2.75
85	90	2.20
90	--	1.925

The investments mentioned in the above schedule are required to be made in "Texas Securities" defined by the statute.[73] These may be summarized as:

(1) All Bonds issued under the Federal Farm Loan Act approved July 17, 1916, when secured by unencumbered Texas real estate.

(2) Bonds of the State of Texas

(3) Bonds or interest-bearing warrants of any county, city, town, school district, or other municipality or subdivision authorized to issue such under the Constitution and laws of Texas.

(4) Notes or bonds secured by Texas real estate and guaranteed by the United States or the State of Texas.

(5) The average monthly balances deposited in national or state banks and trust companies in Texas.

(6) That percentage of a life insurance company's investments in the bonds of the United States of America that its Texas reserves are of its total reserves, but in no event in excess of the amount of bonds of the United States of America reported by said company as Texas securities in a Texas tax return covering the year 1946.

[73] Tex. Civ. Stat. (Vernon, 1948) art. 4766. All companies authorized to do business in Texas will have at least 75 per cent of their "Texas reserves" invested in Texas because of the Robertson Act, but this, of course, is a different percentage from the one discussed here. The Robertson Act specifies 75 per cent of the legal reserves required on account of policies written on Texas citizens.

(7) Promissory notes and other obligations, the payment of which is secured by unencumbered Texas real estate worth at least 40 per cent more than the amount of the loan.

(8) First liens on certain leasehold estates having 30 years or more to run.

(9) First lien notes or first mortgage bonds on any solvent corporation incorporated under the laws of Texas which has paid at least an average of 5 per cent annual dividends on outstanding stock out of actual earnings for 5 years or more.

(10) Obligations secured by "the aforesaid bonds, warrants, notes, cash deposits, and liens."

(11) Loans made to Texas policyholders on the sole security of the reserve value of their policies.

(12) Not more than one building site and one office building in any city of the state of more than 4,000 inhabitants.

(13) Real estate owned in the state. (This was apparently intended to cover those situations when property was acquired by foreclosures.)

In actual practice, the tax-reducing feature of the law is utilized by most of the life companies. Only a few of the property insurance companies use it, probably because the life companies, already required by the Robertson Act to have Texas investments, do not have much added inconvenience in achieving the benefits of tax-reduction.

Investment and Other Income

This tax, based on only one item of an insurance company's income, ignores a substantial part of the company's gross receipts -- its investment and other income. It does not necessarily follow that companies with high premium incomes will always have high investment incomes. A case in point is a contrast of new companies with the old companies. The old companies, with many old policies against which they must carry reserves, will have proportionately larger investment receipts.[74] Another example would be the company writing industrial life policies contrasted with other life companies. A high rate of lapsed policies results in a short average life of the policy; hence proportionately smaller reserves and investment gross income. To accentuate the contrast in this latter case, the industrial companies must charge a higher premium rate, which, of course, renders proportionately higher gross premium taxes.

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74 Edwin R. A. Seligman, Essays in Taxation (New York: The Macmillan Company, 1925), p. 169.

Interpretation

Numerous questions of application have arisen under the law. As they have come up, the Attorney General has been requested to rule on them, and a considerable amount of opinion material has been built up. Many of these opinions were written on statutes as they existed before their latest revisions and are not entirely applicable to the statutes that exist today. A meticulous sorting and weighing of these opinions is hardly justified in a general survey treatment such as this. However, those who care to study them further may find them carefully collected in Texas Laws on Insurance.[75]

As examples of some of these rulings which may prove of significance today, the following may be mentioned. Companies paying the gross premiums tax are not relieved of paying the fee charged for filing certified copies of their charters, statements, and other such papers.[76] Taxes must be paid to the Treasurer on or before March 1. If not, a penalty of ten per cent of the tax is charged after a grace period of 30 days.[77] Such defaulting company may have a certificate of authority to transact business in this state revoked[78] and be fined $25 per day for each day in default.[79]

If the company wishes to controvert the tax, it should make the payment under protest. Until the payment is made, the certificate of authority to transact business may be withheld.[80] The entire premium on floater policies is includable if the property is in the state at the time it is written, though it is later taken out of the state and though the owner does not reside in the state.[81]

A loan made by a fire insurance company to a Texas resident secured by stocks or bonds of a corporation organized in another state was held to be a good tax-reducing investment by the Attorney General.[82]

An example of a company which was held to be not subject to the tax because it was found to be a "purely cooperative mutual fire insurance company carried on by the members thereof purely for the protection of their own property, and not for profit" was the subject of an opinion in 1938.[83]

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75 Edited and compiled by William J. R. King (Austin: Von Boeckmann-Jones Company, 1949), Pocket Supplement.

76 Op. Tex. Atty. Gen. (June 5, 1905).

77 Op. Tex. Atty. Gen. (March 20, 1930).

78 Tex. Civ. Stat. (Vernon, 1948) art. 4775.

79 Ibid., art. 4776; Op. Tex. Atty. Gen. (March 20, 1930).

80 Op. Tex. Atty. Gen. (February 20, 1933).

81 Op. Tex. Atty. Gen. (May 15, 1933), citing Tex. Rev. Civ. Stat. (1925). Art. 5058.

82 Op. Tex. Atty. Gen. (May 15, 1933).

83 Op. Tex. Atty. Gen. (March 1, 1938).

Premiums received by a foreign title company from a domestic title company for reinsurance were ruled not to be includable in gross premiums for computing the tax.[84]

Maintenance Taxes

Certain insurance companies are required to pay maintenance taxes in addition to the gross premiums tax. For instance, fire and casualty insurance companies may be taxed not exceeding 1-1/4 per cent of their gross premiums; casualty and fidelity companies not exceeding 2/5 of one per cent; motor vehicle insurance companies 1/5 of one per cent; and title insurance companies not exceeding one per cent.[85] Revenues from these taxes are earmarked solely for the purpose of administration, and the rates may be adjusted by the board on the basis of administrative need.

84 Op. Tex. Atty. Gen. No. V-516 (March 9, 1948).

85 State Tax Guide (Commerce Clearing House, 1951), p. 8552; Acts 49th Leg., R. S. 1945, ch. 245, p. 383 and ch. 160, sec. 12, p. 213; Acts 45th Leg., R. S. 1937, ch. 335; Acts 40th Leg., R. S. 1927, ch. 253.

SECTION 4 - COLLECTION AND ENFORCEMENT

The collection process for the gross premiums tax is simple and expeditious. Since the information on which the tax is computed is required by the board for other purposes, very little additional work is required in handling the tax collection. In fact, only two employees -- the tax deposit supervisor and one assistant -- are needed to do the work.

Complete tax coverage, which is a major problem for administrators of most taxes, is practically assured for the gross premiums tax because of the well-enforced licensing provisions.

Each fall an annual statement form, together with the gross premium tax return forms, is mailed to every company doing business in Texas. (See Table Ins - 5).

TABLE INS - 5

Insurance Companies Doing Business in Texas

As of 8-31-50	Texas	Foreign	Total
Stock Life	99	86	185
Mutual "	11	35	46
Stock Fire	16	236	252
Mutual "	11	45	56
Stock Companies	27	119	146
Mutual "	2	23	25
Lloyds "	21	1	22
Reciprocals	4	21	25
Fraternals Do Not Pay	8	32	40
Title Insurance Companies	11	3	14
Assessment, Life and Health	0	1	1
Legal Reserve, Stock, etc.	210	602	812
Mutual Assessment Life, Health & Accident	52	--	52
Local Mutual Aid Assessment	245	--	245
Burial Associations	416	--	416
Exempt Associations	20	--	20
Non-profit Corporations	2	--	2
County Mutual Fire	57	--	57
Farm Mutual	34	--	34
	826		826
Grand Total	1,036	602	1,638

Shortly after the close of the year, these statements and returns begin to trickle back to the board, increasing steadily in volume as the March 1 deadline approaches. Some of the field examiners are usually called into the office to help process this peak load.

Returns are received by the tax and deposit supervisors. Company checks in payment of the tax are attached to returns in nearly every case. These are detached immediately by the supervisor and sent to the Treasurer after a memorandum bookkeeping entry is made to record their receipt. Only the memorandum entry is made because it would be impossible to refund an overpayment without an act of the Legislature if the money had actually been credited to a state account. The procedure used enables the supervisor to check the return and refund any overpayment due the company.

As soon as the check is transmitted to Treasurer, an audit of the return is made by the tax deposit supervisor to check for mathematical errors and deviations from the law in computation of the tax. The audit consists chiefly of checking the tax return against the company's annual statement, which is made in infinite detail and sworn to by two officers of the company. In most cases, the return is found to be correct. If questionable items are found, the tax supervisor may confer with the chief actuary, the chief clerk, the legal examiner, or even the life insurance commissioner, depending on the nature of the problem.

When incorrect returns are discovered, the point in error is settled with the insurance company through correspondence by the tax supervisor. The companies seem to be co-operative, and payments under protest have not been made for decades at a time.

When the tax supervisor determines that the payment is correct, this fact is noted. The annual statement, together with all notes and memoranda made by the tax supervisor, is passed on to the chief actuary (if for a life insurance company) or the chief clerk (if for another type of insurance company) so that it may be examined for solvency. Solvency found, these officers authorize renewal of the company's certificate to do business in Texas.

Any new questions involving interpretations of the law are referred to the legal examiner. He, in turn, may pass them on to the Attorney General by making a request for an opinion in the name of the Life Insurance Commissioner.

Thus the collection procedure for the gross premiums tax is very simple. However, it must be remembered that the tax is an adjunct to the principal work of the board. Were it not for the procedure already established for determining the solvency of insurance companies, the collection process would be considerably more involved.

Enforcement

The staff of field examiners maintained by the Life Insurance Commissioner to check the solvency of every insurance company doing business in Texas presently consists of 27 men under the direction of the chief clerk. Unless circumstances call for more frequent checks, domestic companies are examined every two years.[86] Companies not organized under the laws of Texas are examined at the discretion of the board.[87]

Tax returns are audited again in the process of these examinations. The tax returns for every state in which the company does business as well as those for Texas are checked by the examiners. Discrepancies discovered on these re-checks are not numerous, but they cannot be said to be uncommon.

Companies doing business exclusively in Texas are checked by Texas examiners, but those chartered in foreign states or Texas companies doing business in other states are usually audited under a cooperative plan worked out by the National Association of Insurance Commissioners. Under this system, the United States is divided into six zones of eight states each. Texas falls in zone 5 along with Arkansas, New Mexico, Oklahoma, Kansas, Nebraska, Wyoming, and Colorado. When a company operating in three or more states is examined under the plan established by these agreements a representative from each zone is designated. Thus it is possible that a company operating in 48 states may be examined by representatives of all six zones. Each representative is designated by his zone chairman, and in the process of the audit, he examines the tax returns for all states in his zone.

These examinations include a verification of all assets of the company and careful scrutiny of documentary proof of such things as mortgage loans. It is not uncommon for examinations to extend over a period of months. They have been known to require more than a year in the case of larger companies. It is apparent, then, that they are thorough.

No stereotyped procedure is followed in making examinations. Practices in accord with good accounting procedure and suited to the circumstances of the case are used. For larger companies, unit examiners are assigned to different aspects of the examination. This arrangement is worked out by the examiners. When the examination is completed, each participant writes a report to all state insurance commissioners interested in the company under audit.

In most cases, records of insurance companies are found to be correct and are verified, but misinterpretations of the statutes of a given state will be

86 Tex. Civ. Stat. (Vernon, 1948) art. 4690.
87 *Ibid.*, art. 4690a.

found occasionally. One type of discrepancy encountered from time to time concerns allocation of premiums among the states. For example, a large concern operating in a number of states may purchase a blanket fidelity bond for all its branches. The original contract may be written in New York and all premiums may be credited to that state originally because of inadvertence in the accounting office of the insurance company. When this situation is found, an allocation of the premiums is made on the basis of employees under bond, and the gross premiums tax allocable to the various states is adjusted.

The tax law supplies a potent weapon for enforcement. If taxes are not paid, the insurance company simply does not receive a permit to do business in the state for the ensuing year. In view of this, it is interesting to consider the dissimilar statutory treatment of two types of insurance companies. The property insurance companies are required to pay the tax prospectively and the personal insurance companies retrospectively. In other words, the property companies pay in March for the privilege of doing business in Texas during the year beginning with the preceding January. This payment is calculated on the basis of premiums collected by the company for the preceding calendar year. The personal insurance companies also pay in March, but their payment is for the privilege of doing business for the year ended the preceding December. Hence, the property insurance companies pay their annual occupation taxes in advance, and the life insurance companies--domestic and foreign -- pay their occupation tax in arrears.[88]

Penalties

No special penalty is applicable to property insurance companies for failure to make required reports and pay the gross premiums tax other than loss of the right to continue doing business in Texas.[89]

In the case of life insurance companies, however, the statutes provide that if a company intentionally fails or refuses to comply with the law in making reports and remittances, the Board of Insurance Commissioners is required to give notice of intention to revoke the company's certificate of authority to transact business in the state. If the requirements are not fulfilled within 30 days, it is the duty of the board to revoke the certificate. Once revoked, the certificate cannot be restored for at least one year.[90]

If the failure of the life insurance company to comply with the statute and rules is intentional, it may also be subjected to a penalty of $25 for each

88 Op. Tex. Atty. Gen., Book 374, p. 496 (December 5, 1946).
89 Tex. Civ. Stat. (Vernon, 1948) art. 7064. "No insurance carrier shall receive a permit to do business in this state until all such taxes are paid."
90 Tex. Civ. Stat. (Vernon, 1948) art. 4775.

day it is in default after receiving notice from the Board of Insurance Commissioners.[91] The statute gives authority to collect the penalty to the Attorney General.

Collection of Delinquent Taxes

Delinquencies in the payment of this tax are infrequent, and those which occur are usually cases of tardy payment. The administrator estimates that there are six or seven such cases per year, on the average, and the delinquents usually hasten to make payments when they are notified.

The last delinquencies of any significance occurred when several life companies withdrew from Texas after passage of the Robertson Act. Some left the state owing premium taxes on business done before departure. Recovery of such delinquent taxes has been made in cases where companies which left the state in 1907 have returned to do business in Texas. (See Table Ins - 1.) However, no collections have been made from the other companies.

Based on a series of English cases dating back to the 18th Century, the long-followed rule that one state will not enforce the revenue laws of another still prevails in the courts of most of the states. A number of cases during the last half-century have continued to support the rule.[92] However, in 1946, the St. Louis Court of Appeals upheld for the first time the right of one state to bring an original suit for collection of taxes in the courts of another state.[93] The court declared that enforcement of another state's revenue laws could not be an interference with the rights of a foreign state because the latter is the motivating party submitting itself to the jurisdiction of a sister state. It was also felt that this rule which was developed in international private law was inapplicable in defining the relationships of sister states of the union. Clearly, no constitutional obstacle exists to permitting such suits, but whether a state must open its courts to a tax suit by a sister state has never been decided by the United States Supreme Court.

To overcome the rigidity of the rule of non-enforcement of out-of-state tax claims, several states have opened their courts by statute to sister states on a reciprocal basis. Up to 1951, 12 states (Alabama, North Carolina, Oklahoma, Oregon, Tennessee, Georgia, Kentucky, Louisiana, Maine, Maryland, Minnesota, and Wisconsin) had enacted interstate comity statutes to facilitate extrastate collection of taxes. The Missouri courts, under a general statutory provision, permit suits in such cases.[94]

91 Ibid., art. 4776.

92 Maryland v. Turner, 75 Misc. 9, 132 N. Y. Supp. 173 (S. Ct., 1911); Colorado v. Harbeck, 232 N. Y. 71, 133 N. E. 357(1921).

93 State of Oklahoma ex. rel. Oklahoma Tax Commission v. Rodgers, 238 Mo. App. 1115, 193 S. W. 2d 919.

94 For a more complete discussion of this general subject, see Extrastate Enforcement of Sister States' Tax Claims, Federation of Tax Administrators (July 1, 1950).

Allocation of Revenues

Allocation of revenues derived from the gross premiums tax is set out in Section XXV of House Bill 285, 52d Legislature. It provides that all revenue other than the part allocated for enforcement purposes (additional taxes levied at varying rates for different types of companies and adjustable by the board on the basis of need for administrative purposes) be allocated one-fourth to the Available School Fund and three-fourths to the Clearance Fund.

SECTION 5 - RESULTS OF OPERATION

Administration of the gross premiums tax is an incidental function of the Board of Insurance Commissioners. If it is regarded merely as an additional duty of that board and if only the expense for the carrying on of this special duty is allocated to the tax, the cost of administration is extremely low. Two employees are collecting some $12,000,000 in taxes annually. However, without the rest of the board's organization to check on insurance companies and their activities in the state, such simple collection procedures and the use of only two employees for the task would not be possible.

Revenue produced by the tax for the last 20 years is set out in Table Ins-2.

Table Ins-2

Revenue From Texas Gross Premiums Tax*

1931-1950

Year Ended	Revenue Receipts (in thousands of dollars)
1931	$ 2,393
1932	2,237
1933	2,014
1934	1,959
1935	2,113
1936	2,270
1937	3,346
1938	3,423
1939	3,255
1940	3,524
1941	3,623
1942	4,903
1943	5,432
1944	6,060
1945	6,201
1946	6,452
1947	7,496
1948	9,393
1949	10,614
1950	12,977

* Includes gross premiums taxes, maintenance taxes, and fees.
TEXAS LEGISLATIVE COUNCIL

Every state in the union has some kind of special tax on insurance companies, and only 14 of them derive a higher percentage of their total tax revenue from insurance companies than Texas.[95]

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95 See Table E-46, facing p. 99, Texas Legislative Council, Staff Research Report No. 51-3, _A Survey of Taxation in Texas - Comparative Revenue Analysis, Texas and Selected States_ (1950).

Table Ins - 3

State	Insurance Premiums Tax Rates by States
Alabama:	All companies - $1.50 per $100 fire and marine. $2.50 per $100 all others - Fire insurance 2/5 of 1% additional fire marshal tax.
Arizona:	All companies - 2%.
Arkansas:	Foreign companies only - 2%. Fire, tornado, marine insurance - 2-1/2% life accident or health.
California:	All companies - 2.35%. 1947 and subsequent years.
Colorado:	All companies - 2%.
Connecticut:	Foreign companies - 1-3/4% on life insurance. 2% on others - domestic companies - 5% (1950) on interest and dividend income.
Delaware:	All companies 1-3/4% - Fire insurance 2% additional. Insurance carriers - 4%.
Florida:	All companies - 1% on annuity payments - All others 2%.
Georgia:	All companies 2% graduated if Georgia securities owned to 1/4 of 1% - 1/10 of 1% on fire insurance additional.
Idaho:	All companies - 3%. Reduced to 1% if 50% of securities owned are Idaho securities.
Illinois:	Foreign companies - 2%.
Indiana:	Foreign companies - 3%: 3/4 of 1% on fire insurance. Additional.
Iowa:	All companies - 2%.
Kansas:	Foreign companies - 2%: $2 per $100 on fire insurance. Additional.
Kentucky:	Foreign Companies - 2%: 1/2 of 1% on fire insurance. Additional.
Louisiana:	All companies - life. Health and Accident - $140 minimum to $310 per $10,000. Fire, marine, and river: $180 minimum to $380 per $10,000. If 1/6 of total assets are Louisiana securities 1/3 of the rate 1/2 of 1% additional on fire insurance.
Maine:	Foreign companies - 2% - Domestic companies 1% - 1/2 of 1% additional on fire insurance.
Maryland:	All companies - 1% on annuities: 2% all others - 1/15 of 1% additional on deposits by fire insurance.
Massachusetts:	Foreign companies - 1/4 of 1% life insurance - 5% fire and marine: All others 2% - Domestic companies, 1%.
Michigan:	Foreign companies - 2% on life and casualty - 3% on fire, marine, and automobile.

Table Ins-3 (brought forward)

Minnesota:	All companies - 2% - 1/2 of 1% additional on fire insurance.
Mississippi:	Foreign companies - 2-1/4 on life, health, accident, and industrial; 3% on all others - Rates reduced 1/3 if 80% of investments are Mississippi securities: Domestic companies. - difference between ad valorem tax and one-half the tax on foreign companies doing like business.
Missouri:	All companies - 2%.
Montana:	All companies. If $5,000 or less premiums. $125: Over $5,000. $20 per $1,000 as a license tax - 1/4 of 1% additional on fire insurance premiums.
Nebraska:	Foreign companies - 2% on life insurance - Domestic companies - 1/4 of 1% on life insurance - Fire companies - Property tax rate plus 1/2 of 1%.
Nevada:	All companies - 2%.
New Hampshire:	All companies - 2%.
New Jersey:	All companies - 2% on life insurance - 1% paid on annuity contracts. All others - 2%: 5% on marine.
New Mexico:	All companies - 2%.
New York:	Paid under insurance law: foreign companies, 1 to 5%; alien companies - 1-3/4 to 5% - additional tax law: foreign companies - 1 to 2%; alien companies - 1/2%: domestic companies - 1-3/4 to 2%.
North Carolina:	Foreign companies - 2-1/2% of annuities and other insurance. Domestic companies 1%: 4% on workmens' compensation: 1/2 of 1% additional on fire insurance.
North Dakota:	All companies - 2-1/2%, 1/2 of 1% additional on mutual and domestic fire insurance.
Ohio:	Foreign companies - 2-1/2% - Domestic companies. 2/10 of 1% but not less than $25 - 1/2 of 1% additional on fire insurance.
Oklahoma:	Foreign companies - 4% with schedule of 2 to 30% reduction for Oklahoma securities owned - 5/16 of 1% additional on fire insurance. License fee: $100.
Oregon:	All companies - 2% - 1/2 of 1% additional on fire insurance.
Pennsylvania:	Foreign companies - 2% - domestic. 8 mills on the dollar.
Rhode Island:	All companies. 2% - 5% on marine insurance.

Table Ins-3 (brought forward)

South Carolina:	Foreign companies. 2%. Tax is reduced to 1 to 1-3/4 if investments are certain securities - 1% additional fire insurance.
South Dakota:	All companies - 1% on annuity contracts - 1-1/2% on other insurance - 1% if 20% securities are invested in state. - 1/2 of 1% additional on fire insurance.
Tennessee:	All companies - 2% plus 1/2 of 1% on fire insurance - 1-1/2% on annuities - 4% on workmens' compensation.
Texas:	All companies - 3.5% on life, health, and accident with graduated rates of 1% to 3% if certain per cent of securities owned are Texas securities. If premiums are less than $450,000, rate is 5/8 of 1% - Other insurance 3.5%. With graduated rates of 1 to 2-3/4 - 1-1/4 additional on fire, lightning,. tornado, windstorm, or hail - 1/5 of 1% additional on motor vehicle - 3/5 of 1% additional on workmens' compensation - 2% additional on fire insurance - 1% additional on title insurance.
Utah:	All companies - 2-1/4 % - 5% on ocean marine writing profit.
Vermont:	All companies 2% - 1/4 of 1% additional on fire insurance.
Virginia:	All companies - 2-1/4% on life insurance. - 1% on mutual. - 2-3/4% on all others.
Washington:	All companies - 2%. Ocean marine and foreign trade insurance contracts. 3/4 of 1%.
West Virginia:	All companies - 2% - 1/2 of 1% additional on fire insurance.
Wisconsin:	All companies - 2-3/8% on fire and marine - 2% additional on fire insurance - Life insurance 3-1/2% on domestics - 2% on foreign - Casualty and surety companies 2%.
Wyoming:	All companies - 2-1/2%.
DISTRICT OF COLUMBIA:	All companies - 2%. [96]

(The term "all companies" means foreign and domestic companies.)

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[96] Know Your States Series, Bulletin No. 4, Revised - 1950 "Forms of Taxes Levied By the States." For another brief comparison but one slightly more in detail, see Commerce Clearing House, Inc., Tax Systems, 12th ed., pp. 274-283 (1950).

Taxes on insurance companies are seventh as revenue producers for the state of Texas, being outranked only by the severance or natural resources production tax, motor fuel tax, general property tax, cigarette tax, motor vehicle license tax, and alcoholic beverages tax. The gross premiums tax is, of course, by far the most fruitful of all special insurance taxes. This comparison does not give credit to insurance companies for ad valorem taxes paid [97].

Obtaining 3.3 per cent of its total revenue from the insurance industry, Texas is getting more from this source than most states. The national average for this exaction has been increasing during the last decade, and in 1950, the average state got 2.7 per cent of its taxes from insurance companies, not counting property taxes from this source.

In dollars and cents, insurance companies in 1950 paid to Texas $12,977,081.14. Of this amount, the gross premiums tax accounted for $11,791,885.03. Maintenance taxes amounted to $686,945.95, and the fees (such as agents' license fees, filing fees for annual statements, charter fees, etc.) brought in $498,250.16.

[97] Ibid.

SECTION 6 - SUMMARY AND PROBLEM AREAS

The gross premiums tax is a rather simply administered tax against the premium income of most kinds of insurance companies. Insurance taxation was begun in Texas in 1862; and the basic pattern for the current tax was established at the turn of the century.

A consideration of the operation of this tax reveals two general problem areas. First, it might be appropriate to examine the effect of the tax in operation to determine whether certain discriminations result among those directly affected by the tax and whether any such differences in treatment are reasonably founded. Second, it may be desirable to re-examine the statutory exemptions to determine whether they now serve their intended purposes and whether they are reasonable in view of current conditions.

Tax administration, which usually presents problems needing legislative attention, produces no apparent difficulties for this tax. It is assigned to the agency which regulates the insurance industry, and much of the enforcement of the tax is an incidental result of the regulatory activity of the Board of Insurance Commissioners. However, a minor matter might be noted. The meaning of "risks allocated in this state" and "lives of Texas citizens" might be made more explicit in the law so that the allocation of premiums on blanket policies covering more than one state would be made more accurately by the insurance companies. This is not a serious deficiency, however, as most affected companies are familiar with what is specifically required and as the examiners are likely to discover errors in allocation.

Resulting Discriminations

An impelling force behind insurance taxation, and perhaps insurance regulation, in the early period of concern with this subject in many states was to favor the local insurance companies by penalizing to a degree the foreign companies and so creating a sort of incubator atmosphere for the domestic concerns. The pattern of tax discrimination against the foreign insurance company has continued down to the present day in many of the states, including Texas. The *South-Eastern Underwriters* case raised serious questions concerning the constitutionality of this difference in treatment, but the McCarran Act and the subsequent *Benjamin* case set at rest any doubts and declared that the states may discriminate if they wish.[98]

This difference in tax treatment involves a large number of policy considerations and is of such long standing that little interest may exist in reopening the problem. Certain other discriminations which result from the

[98] A discussion of the details of this matter may be found in section 1 of this chapter.

operation of the law are not as apparent and may not be the result of conscious legislative policy. They possibly deserve some attention.

Before they are taken up, it may be helpful to review certain aspects of the conduct of the insurance business. It should be remembered that the insurance business is a heavily regulated activity. Texas, through the Board of Insurance Commissioners, sets or approves the premium rates for all insurance coverages written in the state. In arriving at the rates to be charged policyholders, the two principal factors considered are losses and expenses. Taxes paid by insurance companies constitute an expense item that must be taken into account in establishing rates. The rates are set to give the efficient insurance company a reasonable margin of profit or participation, after subtracting losses and expenses from income. Given the state policy of concern for the solvency of insurance companies so as to protect the insurance buyer and his beneficiaries, it is not feasible to increase the tax obligations of insurance companies in any significant amount without making some adjustment in rates. It can be seen, then, that the insurance buyer feels quite directly the impact of a gross premiums tax in the amount of the premium he must pay.

Certain consequences flow from these factors. Changes in the tax rate may have certain unexpected results. For example, an increase in the tax rate on gross premiums would appear to affect the purchaser of property insurance by requiring him to pay a higher premium when he renews his policy. Life insurance, however, is sold on a long-term basis; thus it is not possible or practicable to raise the premiums when increases in gross premiums taxes require it. The increased tax load must be carried by new life-insurance buyers and not by those with outstanding policies. As to life insurance, then, an increase or decrease in rates will not affect the premiums due from persons holding policies (although they may feel the effect in dividends, if any, they receive); the gain or loss resulting from the tax change will be absorbed generally by those who buy insurance after the change. This may be an unintended consequence of a tax policy regarding gross premiums taxes.

Exemptions

An examination of the gross premiums tax statutes will reveal a number of exemptions. Exemptions generally present troublesome policy questions. Occasionally, a tax law will contain an exemption that has outgrown its purpose; the facts of the business environment in which the tax operates have changed since the establishment of the exemption so that its original object can no longer be realized. Sometimes the tax operates so that the intended purpose of the exemption cannot actually be attained. The following statement concerning tax exemptions generally may be worthy of note:

In the days of lower rates, tax exemptions were regarded as pleasant gratuities to worthy causes, that cost nothing to the rest of us. As governmental costs increase, it becomes more and more evident that tax exemption to A means not merely that A is not required to support the government at all, but also that B, C and D, the other taxpayers, will have to pay proportionately more by virtue of A's exemption. Obviously, if $1,000 of governmental costs is divided four ways, among four taxpayers, each will pay less than if $1,000 of governmental costs is divided three ways among three taxpayers. If the governmental costs are not $1,000 but $1 billion or $10 billion or $50 billion and the number of taxpayers is not 3 or 4 but 30 or 50 million, per capita costs are harder to compute, but the conclusion is not changed.[99]

Among exemptions from this tax that may deserve re-examination is that applying to fraternal benefit societies and fraternal insurance[100] associations or societies that limit memberships to one occupation. If this exemption is based on the ground that they are non-profit organizations operated solely for the benefit of the members, cannot the same be said for all mutuals? In 1949, 47 such fraternal organizations were operating in Texas and developing a premium income of $8,187,449.

Local mutual aid associations and local mutual burial associations are also exempt. They are conceived to be non-profit organizations. However, questions have been raised which may indicate that a study may be in order to determine whether this is true in substance. In 1949, there were 659 such organizations operating in the state and receiving total premiums of $8,971,686.

County mutuals in the property insurance field carry on a sizable insurance business not subject to the tax. Over the years, the character of the operations of a number of these organizations have changed from the small informal rural groups established for the collective protection of members in the community towards something more resembling the ordinary insurance institution. This, plus the fact that they do compete with other insurance concerns, may indicate that the exemption deserves re-examination. In 1949, 59 such organizations were operating in Texas and collecting premiums in the amount of $3,528,724.

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99 Magill and Merrill, The Taxable Income of Cooperatives, 49 Mich. L. Rev. 167, 167-168 (1950).

100 The following discussion of exemptions is based on data in Table Ins -4.

TABLE INS - 4

Insurance Organizations Exempt from Gross Premiums Tax

Type of Company	Number of Companies	Amount of Premium Income
Local Mutual Burial Associations (art. 4875a-5068-1 through 5068-7)		
Year 1945	375	$ 3,237,330
1946	410	3,746,453
1947	426	3,949,026
1948	419	3,573,588
1949	421	3,750,254
Local Mutual Aid Associations (art. 4875a-5068-1 through 5068-6)		
Year 1945	160	3,553,299
1946	182	4,247,097
1947	200	4,633,160
1948	228	4,965,586
1949	238	5,221,432
Exempt Companies (Employer group, art. 4859f, sec. 6)		
Year 1945	22	135,416
1946	22	149,270
1947	20	168,298
1948	18	206,451
1949	20	340,807
Group Hospitalization Companies (art. 4590a)		
Year 1945	2	909,885
1946	3	1,386,536
1947	3	2,416,544
1948	2	3,900,800
1949	2	4,935,781
Farm and County Mutuals (Combined)		
Year 1945	46	597,317
1946	61	935,818
1947	68	1,648,463
1948 (Farm)	35	542,218
1948 (County)	47	2,774,633
1949 (Farm)	34	633,214
1949 (County)	59	3,528,724

Type of Company	Number of Companies	Amount of Premium Income
Fraternal Orders (Texas Business only - art. 4822, ch. 8)		
Year 1945	47	$ 7,015,216
1946	49	7,488,949
1947	50	8,612,161
1948	48	8,990,780
1949	47	8,187,449

Source: Letter from Will G. Knox, Legal Examiner, Texas Board of Insurance Commissioners, dated August 14, 1951.

TEXAS LEGISLATIVE COUNCIL

First-Year Premiums

The first year's premium collected by the personal insurance companies is not subject to the gross premiums tax. The only apparent reason for this exemption is the thought that the first premium on such a policy represents primarily recovery of the policy's acquisition cost, including such items as the agent's commission, and that it would impose an undue burden on the company to require it to pay a tax on a premium from which it realizes little. This seems to alter the general approach of the tax law; this tax is not strictly based upon an ability to pay measured by what the company ultimately realizes upon its gross premium income. It is based on ability to pay only to the extent that gross premiums are a measure of such ability. In this one instance, the tax law seems to borrow a principle underlying income tax laws.

A by-product of excluding first-year premiums is that much "credit life insurance" and "credit health and accident insurance" business goes untaxed. This business is written because many personal or small loan companies often require their borrowers to take out insurance in favor of the company to secure repayment of the loan in case of death or disability of the borrower. The loan company frequently acts as insurance agent in the sale of these policies. Customarily, they are written for the term of the loan; in fact, the law prohibits the credit life insurance policy to be for more than one month longer than duration of loan or one year, whichever is longer, and credit health and accident policies to be for more than one month longer than the term of the loan.[101] As most small loans are for less than one year, this means that premiums will generally cover only one year or less of personal insurance.

As mentioned in section 3 of this chapter, where this subject is discussed in greater detail, some consider this practice to involve strong elements of a subterfuge by certain loan companies to increase the effective return on their money above the 10-per-cent maximum allowed by law. This may be accomplished by coercing commissions on such insurance sales and yet staying within the letter of the usury laws. The fact that this kind of insurance is referred to as "credit insurance," both in current laws and in the loan business, indicates that it is essentially different from usual life, health, and accident insurance and that it may properly receive a different tax treatment.

Annuity Premiums

The premiums or "considerations" for annuity policies are not subject to the gross premiums tax, while premiums paid for life insurance, a different but still related insurance contract, are, of course, taxed. A possible reason may be the thought that annuity premiums represent primarily an investment or

[101] Acts 52d Leg., 1951, ch. 207, p. 336, sec. 1.

savings, yielding monthly payments in old age, for example, and is essentially different from insurance which protects against certain risks and hazards. However, analysis seems to indicate many life insurance contracts also involve savings or investment features. Actually, individual savings deposited with insurance companies are greater than deposits in either commercial or savings banks; and insurance companies are probably the greatest single reservoir for savings.[102] To the extent that a portion of a life insurance premium payment represents the establishment of a cash surrender value of the policy, it would seem it represents an investment or savings deposit by the insured. To this extent, then, the gross premiums tax is a tax on making an investment or savings deposit. It seems that the difference annuity and life insurance policies is not as great as it might appear.

In conclusion, it might be noted that any change in the gross premiums tax might best be made only after a consideration of its ultimate affects. If the analysis of effects of the tax upon insurance buyers has any validity, it would seem that significant changes in the tax will result in premium-rate changes. Some of these adjustments can be made more easily and readily than others; thus each proposed change may deserve separate consideration.

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[102] The Tax Foundation, Facts and Figures on Government Finance, 1950-1951, p. 21.

Chapter III

INHERITANCE TAX

SECTION I - HISTORICAL AND LEGAL DEVELOPMENT

The inheritance tax is a type of death tax levied on the passage of property at the death of the owner. The tax covers property transferred by both will and intestate succession (i. e., distribution of property of the deceased in accordance with statutory provisions where no will exists). It is common today for the tax to apply even to some property transfers made prior to the death of the owner, as in the case of transfers made by the decedent in contemplation of his death.

Antiquity of Inheritance Taxation

The levy on inheritance is one of the earliest recorded forms of taxation. Old manuscripts dating back to 700 B. C. give evidence that inheritances were taxed by the ancient Egyptians.[1] Emperor Augustus is credited with instituting in Rome in 6 A. D. the *vicesima hereditatium*, a tax on inheritances and bequests. It is believed that some time after 212 A. D. the *vicesima hereditatium* was extended to the British Isles, then under Roman occupation. During the Middle Ages England had the feudal "relief," considered by some to be the direct forerunner of the modern inheritance tax, and later a stamp duty on the probate of wills and letters of administration was imposed by the Stamp Act of 1694. However, these early taxes apparently took no account of differences in the sizes of estates involved, and it was not until the Probate Duty Act of 1779 that the tax was computed with reference to the value of the estate, requiring larger estates to pay a greater amount. By the 18th Century, inheritance taxes of one sort or another were also being employed on the Continent.[2] Justification for the early inheritance taxes seems to have been found in the doctrine that the sovereign held full title to all land and that the tax on passing property to heirs or beneficiaries was exacted by the sovereign for permitting the beneficiaries to take the land.

Mr. Justice McKenna, in *Magoun v. Illinois Trust & Savings Bank*, 170 U. S. 283, 287-288, declared that inheritance taxes had been found constitutional on the basis of two principles:

1. An inheritance tax is not one on property, but one on succession.

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1 William J. Shultz, *The Taxation of Inheritance* (New York: Houghton Mifflin Company, 1926), p. 3; O'Brien, *Michigan Inheritance Tax*, 24 Mich. B. J. 253 (1945).

2 *Ibid.*, p. 16.

2. The right to take property by devise or descent is a creature of the law, and not a natural right -- a privilege, and therefore the authority which confers it may impose conditions upon it. From these principles it is deduced that the States may tax the privilege, discriminate between relatives, and between these and strangers, and grant exemptions; and are not precluded from this power by the provisions of the respective state constitutions requiring uniformity and equality of taxation.

Taxes of this general nature have been variously referred to as death taxes, death duties, succession taxes, succession duties, inheritance and legacy taxes, probate duties, legacy taxes, and estate taxes.

Death Taxation in the United States

Death taxes in the United States today fall into two major categories -- estate and inheritance taxes. The estate tax, as employed by the federal government and a number of states, is levied on the net estate before it is distributed or divided among the beneficiaries. The inheritance tax, on the other hand, is based on the size of the shares which individual beneficiaries receive. In imposing the tax, consideration is given to the degree of relationship between the beneficiary and the decedent -- the closer the relationship the lower the rate. The tax is conceived to be on the right to receive, in the case of the inheritance tax, and on the right to transfer property, in the case of the estate tax, as distinguished from a tax levied against the property itself. Stated another way, an inheritance tax is based upon the interest to which some person succeeds on death, while an estate tax is based upon the interest which ceased by reason of the death. Thus, these taxes are not considered direct taxes and thereby escape the constitutional limitations which apply to property taxes.[3] In effect, death taxes are excise taxes, i.e., those levied on a privilege or an occasion rather than directly on property. However, the computation of the tax is based on the value of the property transferred.

Although death taxation is today an accepted part of governmental revenue programs, it caused considerable debate in the early stages of its development.

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3 Knowlton v. Moore, 178 U.S. 41 (1900). Article I, section 9 of the federal constitution provides that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census. . . ." This requires that a direct tax, such as a tax on land, must be apportioned among the states on the basis of population.

A number of theories and arguments, both in support of and in opposition to the imposition of such a tax, were widely propounded. These reveal to a great extent the environment in which death taxation had its beginning in the United States.

Early opposition to death taxation was based on its alleged interference with the right of personal possession of property. It was argued that the right to possess property and transmit it at death were natural rights and that "the institution of inheritance was. . . indispensable to the development of families and progress of society."[4]

It was also contended that death taxes took from the individual all incentive to save. Unable to pass his property to his family unimpaired, a man would lose interest and ambition.[5] Some opponents asserted that the inheritance tax dissipated capital; it was argued that accumulation of capital is necessary to our expanding economic system and that this tax would dry up the sources of investment capital. The argument was also advanced that death taxes broke up productive business units by requiring part of the business or interest therein to be sold to get the cash to pay the tax, thus resulting in a change of management. It was also stated that death taxes deterred philanthropy, thus raising the question of whether individuals are capable of disposing of their money more intelligently than the government.

Advocates of death taxes argued that what the beneficiary receives is "unearned" and therefore no injustice is caused by a tax.[6] Carried to its logical extreme, this could mean that the government might tax away the entire estate through taxes, since it is all unearned so far as the beneficiary is concerned. Perhaps our present policy of restricted death taxation is a result of a compromise of these ideas. Those who would levy death taxes because of the unearned nature of the income also concede that certain individuals might have been financially dependent upon the decedent during his lifetime. Recognition of the desirability of allowing the deceased to provide for such persons is reflected in present laws granting greater exemptions and lower rates to bequests to persons closely related to the decedent.[7]

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[4] Shultz, _op. cit._, p. 169.

[5] Harold M. Groves, _Financing Government_ (rev. ed., New York: Henry Holt and Company, 1945), p. 231.

[6] _Report of the Senate Interim Committee on State and Local Taxation,_ Part Three, "State and Local Taxes in California: A Comparative Analysis, "California Legislature, R. S. 1951, p. 462.

[7] _Ibid._, p. 463.

Some fiscal theorists sought to justify death taxation on the "ability-to-pay" theory, stating that the recipient possesses ability to pay, since he suffers no loss by paying the tax out of property he is to receive. One cannot lose something he never had; thus the tax is merely a decrease in "potential satisfactions."[8]

It has been further argued that each person should be permitted to begin life with equal opportunity and go as far as his individual talents and initiative will take him, instead of forcing less fortunate individuals to compete with those who begin life with large fortunes left them by ancestors.[9] In the same vein were contentions that the present distribution of wealth is undesirable and that death taxes provide a means for dividing concentrated wealth and power. Additional arguments in favor of death taxes were that they are easily assessed and collected, that they cannot be shifted, and that they reach property upon which the owner may have avoided taxation during his lifetime.[10]

Early Period of Death Taxation

The state governments enacted death tax legislation before the federal government entered the field. The early period of death taxation in the United States saw the states imposing two types. One was in the nature of a probate fee --, a uniform amount payable on all estates; the other was a collateral inheritance tax computed by taking a certain percentage of the value of the property inherited and exempting bequests to direct heirs. Direct heirs are the surviving spouse, parents, and descendents of the decedent. Hence, a collateral inheritance tax is a tax levied against bequests to persons other than direct heirs.[11]

The collateral inheritance tax marked the beginning of the development of our present-day inheritance taxes. However, the early collateral tax laws did not graduate the tax according to the degree of relationship between the decedent and the heirs. Nor did they provide for progressive rates which increased with the amount of the inheritance, as do most of our present laws.

Pennsylvania, in 1826, was the first state to enact a collateral inheritance tax. The rate was 2 and 1/2 per cent.[12] Only a dozen states enacted death taxes within the next 60 years. Half of these were collateral inheritance taxes; the others were in effect probate fees. It is significant that many of the early collateral inheritance taxes applied only to personal property and not to realty.

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[8] Ibid.

[9] Ibid.

[10] Ibid., p. 231.

[11] William J. Shultz, American Public Finance, (2nd rev. ed. New York: Prentice Hall, Inc., 1938), p. 422.

[12] Pennsylvania Laws 1826, c. 72.

The early death taxes have been characterized as lacking effective administration.[13] The courts as well as enforcement officials were unsympathetic; hence, most of the statutes were declared unconstitutional within a few years after they were enacted. The revenue produced by these early taxes was insignificant.[14]

The first workable and enforceable inheritance tax law came with the New York act of 1885. The uniqueness of this law seemed to lie in the fact that its administrative provisions were very carefully drawn. Like many of the previous laws, it was a collateral tax. Many states enacting inheritance tax laws immediately after 1885 adopted the New York act as a model.[15]

A few years later in 1892, New York introduced an innovation in inheritance taxes by including direct heirs among beneficiaries liable for the tax.[16] Although North Carolina had taxed direct heirs as early as 1855,[17] it abolished the law shortly afterward. Consequently, New York is credited with the development. New York's direct inheritance tax, however, covered only personalty passing to direct heirs and levied no tax on the passage of realty.

In the early stages of inheritance taxation when agrarian interests dominated state legislatures, the trend seems to have been to apply the tax only to personal property. It was not until the turn of the century that the coverage of realty by the tax became generally accepted in the United States.[18]

The Beginning of the Modern Period

The New York direct inheritance tax proved to be the basis of inheritance tax laws which came later. The first significant extension of the New York direct tax idea came in the Wisconsin tax of 1903.[19] Although the short-lived North Carolina act of 1901[20] seems to have laid much of the groundwork for it, "the Wisconsin law was hailed as the first scientific tax act."[21] The Wisconsin direct inheritance tax went even a step further than the New York act in that it covered the transfer of realty as well as personalty. Equally significant were other provisions which divided heirs and beneficiaries into five classes, according to the degree of relationship between the beneficiaries and the deceased, and established progressive rates. The rates were lower on bequests to a surviving spouse or children than those to a person outside the family. In addition, rates increased as the amount of the bequest or devise increased; for example, a greater proportion of a $100,000 bequest would be taxed away than from one of $50,000.

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13 Groves, *op. cit.*, p. 234.

14 Shultz, *American Public Finance*, *op. cit.*, p. 422.

15 Groves, *op. cit.*, p. 224.

16 New York Laws 1892, c. 399.

17 North Carolina Session Laws 1855,c.37.

18 Shultz, *The Taxation of Inheritance*, p. 233.

19 Wisconsin Laws 1903, c. 44.

20 North Carolina Session Laws 1901, c. 9, sec. 12.

21 Groves, *op. cit.*, p. 224.

popularity during the years immediately after 1903, Texas did not follow suit. Instead, it adopted a collateral inheritance tax, exempting transfers to the surviving spouse, parents, and children of the decedent. The Texas tax, however, did adopt the progressive rate feature of the Wisconsin act and also provided for the classification of taxable beneficiaries according to degree of relationship to the decedent. It provided for only three classes, whereas the Wisconsin act had five. Under the Texas act, the rates increased as the relationship became less close and as the amount of the bequest or devise increased, requiring larger estates to pay a higher rate of tax. Like the Wisconsin act, the Texas law taxed the transfer of real as well as personal property.

The classes of taxable beneficiaries under the Texas act were (1) grandparents, brothers, and sisters, and their descendents, (2) uncles, aunts, and cousins, and (3) strangers. The first class paid rates from two to five per cent, the second, from three to eight per cent, and the third, from four to 12 per cent. The act was faulty in that its administrative provisions were poorly drawn, and it was difficult to enforce.[28] Administration of the tax was the responsibility of local county officials (the county judge, county tax collector, and county attorney). It is possible that these officials were hesitant to enforce the act because they feared the disfavor they might gain in their effort to do so. Net collections from the Texas inheritance tax during the early years are given below.

For the Fiscal Year Ending	
1909	$ 7,595
1910	67,396
1911	16,063
1912	47,579
1913	24,333
1914	43,105
1915	22,896
1916	30,006
1917	46,431[29]

Amendments to the act in 1917 and 1919 sought to strengthen it by shifting most of the responsibility for collection and enforcement of the tax to the Comptroller. They provided that the county judge appoint administrators for estates upon which no administration had been taken out and by requiring the administrator, executor, or trustee to file certain reports.[30]

28 Edmund T. Hornton Miller, A Financial History of Texas(Bulletin of the University of Texas, July 1, 1916), p. 321.

29 Annual Reports of the Comptroller of Public Accounts, 1909-1915. Figures for the years 1916-1917 are taken from notes on file in the Inheritance Tax Division, since it is impossible to determine accurately from the Comptroller's reports the amount of revenue collected from the inheritance tax for those two years.

30 Acts 35th Leg., R. S. 1917, ch. 166, p. 377;Acts 36th Leg., R. S. 1919, ch. 164, p. 318.

The adoption of progressive rates in inheritance taxation was preceded by a great deal of opposition. The first state to pass a law providing for progressive rates was Ohio in 1894.[22] By 1900, eight progressive tax bills had been introduced into state legislatures. Five of these failed to become law. Of the three which passed, two were declared unconstitutional. The only progressive-rate inheritance tax law to be upheld was that of Illinois.[23] In the light of the events which preceded it, the passage of a valid direct inheritance tax with a system of progressive rates in Wisconsin was an even more remarkable accomplishment than it may at first seem.

The Wisconsin act replaced the New York law as a model for state inheritance tax laws after 1903. During the years immediately following, the taxation of direct heirs became so well established that no collateral inheritance tax laws were enacted after 1908.[24] The effect of the Wisconsin law's system of rate progressivity and beneficiary classifications can still be detected in most inheritance tax laws. The Wisconsin act, then, started a new trend in this type of taxation and proved that the inheritance tax could be a substantial revenue producer.[25]

In 1905, a significant development appeared when Utah enacted the first estate-type death tax, which, unlike the inheritance tax, was levied against the net estate of the decedent instead of against the individual shares of the beneficiaries.[26] The estate-type tax, however, went unnoticed by the legislatures of the other states as a possible revenue measure until it was adopted by the federal government in 1916.

First Texas Levy Fails to Tax Direct Heirs

Although death taxes of one form or another had been levied by a number of states for about three-quarters of a century, it was not until 1907 that the Texas Legislature, prompted by need for additional revenue, passed an inheritance tax. Two bills previously introduced the same year had failed.[27] In spite of the fact that the practice of taxing direct heirs -- begun a few years earlier by New York, North Carolina, and particularly Wisconsin -- had gained considerable

22 Ohio Laws 1894, p. 166.

23 Shultz, The Taxation of Inheritance, op. cit., p. 283.

24 Ibid., p. 113.

25 Shultz, American Public Finance, op. cit., p. 423.

26 Utah Laws 1905, c. 119.

27 Acts 30th Leg., 1st C. S. 1907, ch. 21, p. 496; see House Journal, 30th Leg., R. S. 1907, pp. 73, 176, concerning the two previous bills.

The effect of the amendments can be ascertained by comparing the net collections after they become effective with those of previous years.

For the Fiscal Year Ending	
1918	$ 32,805
1919	254,995
1920	547,227
1921	95,417
1922	162,227
1923	114,064 [31]

The comparison reflects the substantial increase in revenue after the 1917 and 1919 changes. The 1917 amendment, it seems certain, was primarily responsible for the increase, since before its enactment "no outside effort was made to enforce the Act and collect the tax. Apparently the only tax collected was voluntarily paid by those subject to the tax."[32] Even the increased collections after the amendments did not satisfy the lawmakers. In 1923 the 1907 act, as amended in 1917 and 1919, was repealed, and a new law designed to produce even more revenue was substituted.

The Federal Estate Tax and Credit Provisions

Meanwhile, the federal government had again explored the field of death taxation and had passed the estate tax of 1916. The federal government had levied an inheritance tax on at least two previous occasions, during the Civil War and during the Spanish-American War. Both were on the books for only short periods before being abolished.[33] The 1916 act, also a war-time measure, was the first federal death tax to have any permanency. The tax, which forms the basis of our federal estate tax, was levied against the net estate of the decedent instead of against the individual shares of the beneficiaries, as were the inheritance taxes. An exemption of $50,000 was granted, and rates ranged from one to ten per cent, depending upon size of the estate. For instance, if the decedent left an estate valued at $200,000, the tax was levied against that amount instead of against shares going to beneficiaries. No tax was levied upon the first $50,000; however, the remaining $150,000 was subject to the progressive rates.

The adoption of the federal estate tax, it seems, started a new trend in death taxation. Since that time an increasing number of state legislatures have replaced their older inheritance type taxes with the newer estate type.

31 Figures are from notes on file in the Inheritance Tax Division of the Comptroller's Office.

32 Letter from Cecil Bird, director, Inheritance Tax Division of the Comptroller's Office, to C. H. Cavness, state auditor, dated August 11, 1945. Copy on file with the Texas Legislative Council.

33 Comment, "Death Duties," 6 Va. L. Rev. 568 (1920).

Like the earlier state taxes, the federal death taxes met with a great deal of opposition. Even before the 1916 act, many economists asserted that death taxation was a matter for the states and not for the federal government -- that for the federal government to embark upon this type of taxation would be to rob the states of an important source of revenue. The controversy subsided in 1925 when United States Supreme Court held that both the state and federal governments had the power to tax transfers at death at the same time.[34]

The federal government, however, had already offered a compromise solution to the problem of who should levy death taxes. In 1924 it permitted a 25-per-cent credit against the federal estate tax for state death taxes paid. Under the compromise, the taxpayer was permitted to deduct from the federal estate taxes payable the amount which he had paid as state death taxes up to one-quarter of the total of the federal taxes. For instance, under the 1924 credit provision, if the federal tax on a particular estate amounted to $100,000, a state could collect a tax of $25,000 under its death tax law without any additional burden upon its citizen. In 1926, the credit allowance was raised from 25 to 80 per cent. Also, the exemption was increased from $50,000 to $100,000, and the rates were adjusted to range from 1 to 20 per cent, depending upon the value of the estate. The 1926 tax, with the credit provisions, remains in the law today and is commonly referred to as the "basic estate tax."

In addition to providing a compromise settlement of the problem of who should tax, the federal estate tax had another and probably greater purpose. It provided a compelling inducement to the states to enact uniform inheritance or estate tax laws. Such a uniform system of death taxes provided a solution to a problem caused by the prevalent practice of "tax-cutting." To encourage wealthy persons to become residents, some states were reducing their death tax rates or levying no tax at all. States which had death taxes felt it was unfair for states without such taxes to thus lure away aged persons who had accumulated large fortunes in their state; hence, these states were very much interested in the enactment of the tax credit provision. The coercive effect of the federal credit is readily apparent. If a state levied no death tax, the entire federal tax under the 1926 act went to the federal government. However, if the state had a death tax, the taxpayer would be permitted to deduct the state death taxes paid (up to 80 per cent of the federal tax) from the federal taxes payable. In other words, a state can impose a death tax without increasing the tax burden upon its taxpaying citizen (assuming that the state levied a tax sufficient only to absorb the 80 per cent credit), and the state was permitted to receive a sizable amount of revenue.

Florida actively protested the right of the federal government to enact the credit provision. First, she adopted a constitutional amendment forbidding state inheritance taxation and then proceeded to carry her fight to the Supreme Court of the United States, contending that the credit provision was an unconstitutional interference with the states' choice of their own revenue systems. The Supreme

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[34] _Frick_ v. _Pennsylvania_, 268 U.S. 473 (1925).

Court upheld the federal law by a unanimous decision.[35] The credit provision is today still a part of the federal estate tax. However, the 80-per-cent credit is permitted only against the 1926 or "basic" levy and does not apply to "additional" taxes levied by the federal government since that year. It should be noted that the amount of tax levied under the 1926 act loses some of its significance when compared with later taxes levied by the federal government under the "additional" classification. Rates for the basic tax today vary from 1 to 20 per cent, whereas "additional" taxes have imposed rates varying from 3 to 77 per cent. Whereas the exemption under the basic tax is $100,000, it is only $60,000 under the "additional" taxes.

Many state legislatures were prompt in taking full advantage of the federal credit. New York was first to take advantage of it by enacting a 1925 law which levied an additional tax only to the extent of the difference between the taxes levied under the then-existing New York inheritance tax and the 25 per cent federal credit. In other words, since New York could collect up to 25 per cent of the federal tax without any additional burden on its citizens, it levied taxes to its existing inheritance tax levies to make the total equal to 25 per cent of the federal tax. The additional tax made certain that New York taxes would always at least equal 25 per cent of the federal tax. Of course, if the tax levied under the existing law equaled or exceeded that proportion, no additional tax was levied. In 1926, when the credit was raised to 80 per cent, New York amended her additional tax accordingly.[36] Today all states except Nevada, which levies no death tax at all, take advantage of the federal credit in some manner.

Texas Begins Taxing Direct Heirs in 1923

In 1923, before any federal credit provision existed, Texas was badly in need of additional revenue. In spite of the tremendous increase in revenue brought about by the inheritance tax amendments of 1917 and 1919, there was still agitation that the tax was not being properly administered. The result was the repeal of the 1907 collateral inheritance tax and its amendments and the adoption in 1923 of a tax which applied to direct heirs as well as collateral heirs.[37] The 1923 act with its several amendments is Texas' present inheritance tax law. A significant feature of the act was that it sought to raise more revenue by increasing coverage. Instead of the three classes of taxable beneficiaries under the 1907 act, there were now five. The act designated them as classes A, B, C, D, and E, depending upon how closely related the beneficiaries had been to the decedent. Members of the immediate family of the decedent (class A) were made liable for the tax for the first time, although they were granted a $25,000 exemption and given the advantage of the lowest rates. Also made subject to the

35 Florida v. Mellon, 273 U.S. 12 (1927). Florida amended her constitution in 1930 to allow the legislature to pass a law to take advantage of the federal credit.

36 Shultz, American Public Finance, p. 424.

37 Acts 39th Leg., 2nd C.S. 1923, ch. 29, p. 63

tax for the first time were religious, educational, and charitable organizations located within Texas (class B) when gifts to them were to be used within the State of Texas. These beneficiaries also received a high exemption and the lowest rates. The other three classes of taxable beneficiaries were the same as defined in the original act of 1907. However, changes in exemptions and rates were made.

Rates under the 1923 direct inheritance tax were graduated not only according to the value of the property passing to a particular beneficiary but also according to the relationship between the beneficiary and the decedent. It is significant that the rates under the 1923 act represented an increase over those of the 1907 act as amended. Whereas the rates under the 1907 act ranged from 2 to 12 per cent, those under the 1923 act were from 1 to 20 per cent. Thus Texas followed the general trend of the early 1920's in raising rates.[38]

In the 1923 act, Texas adopted a mode of taxation which New York, North Carolina, and Wisconsin had utilized almost a quarter of a century previously.

The Legislature, in the 1923 inheritance tax, sought further improvement in administration by providing a penalty for failure to file specified reports, by prohibiting the transfer of intangibles until the tax was paid, and by requiring the Comptroller to furnish all necessary forms. Some of the more important administrative provisions carried over from the old law included those authorizing the county judge to appoint appraisers, requiring local officials to aid in enforcement, and establishing a lien on the property transferred to secure payment of the tax.

The full effectiveness of the new law as a revenue measure was not realized until after several years of operation. Collections for the four years after enactment of the new law show that the 1923 law was a much greater revenue producer than its predecessor.

For the Fiscal Year Ending	
1924	$ 149,610
1925	587,546
1926	1,013,645
1927	1,394,891 [39]

In 1925, the entire Texas Civil Code was revised, and the 1923 inheritance tax law, with slight omissions, minor changes, and considerable rearrangement of the sections, became Title 122, Chapter 5, Articles 7117-7144

38 Shultz, The Taxation of Inheritance, op. cit., p. 130.
39 Annual Reports of the Comptroller of Public Accounts, 1924-1927.

of the Revised Civil Statutes of 1925. The Texas inheritance tax law is commonly referred to today as "chapter 5."

The first amendment to the 1923 law came in 1927 as a result, it seems, of a bequest by W. J. McDonald to The University of Texas for the establishment of an astronomical observatory.[40] The amendment provided that gifts to religious, educational, or charitable organizations located in Texas, to be used in Texas, were exempt from the inheritance tax.[41] This exempted from the tax most of the gifts to class B beneficiaries discussed above. The 1927 amendment, in effect, reverted to the situation which existed under the 1907 law concerning taxability of gifts to religious, educational, and charitable organizations.

Another amendment appeared in 1929 to relieve some of the burden caused by repeated tax levies on the same estate in a short period due to a rapid succession of deaths. It provided that transfer of property on which an inheritance tax had been paid within the last five years was exempt from the tax.[42] This exemption is still part of the Texas inheritance tax law. A similar provision appears in the federal estate tax. Many of the states, however, do not permit such exemptions.[43]

A 1931 amendment clarified the taxable status of gifts to persons unrelated to the decedent to be used within the state. It provided that such beneficiaries are within class E and hence are subject to the highest rates and lowest exemption under the act instead of being completely exempt as were religious, educational, and charitable organizations under terms of the 1927 amendment.[44]

In 1933 came another amendment relating to gifts to religious, educational, and charitable institutions. For gifts to such institutions to be exempt from the inheritance tax under the 1927 amendment, the institution had to be located in Texas and the gift had to be used in the state. These requirements were amended so that it was no longer necessary for the institution to be located in Texas; it was only necessary that the gift be used within the state.[45]

40 Acts 40th Leg., R.S. 1927, ch. 149, p. 221. This act released the inheritance taxes due on the McDonald bequest.

41 Acts 40th Leg., R.S. 1927, ch. 62, p. 87. See Acts 40th Leg., R.S. 1927, S.C.R. No. 24, p. 491, for a declaration of the policy of the 1927 amendment: "...to relieve all estates descending to educational, charitable, and religious institutions and beneficiaries as set out in the bill, from payment of state inheritance taxes."

42 Acts 41st Leg., R.S. 1929, ch. 72, p. 109.

43 "Inheritance, Estate, and Gift Tax Service, State" (New York: Commerce Clearing House, 1950), p. 81-029.

44 Acts 42nd Leg., R.S. 1931, ch. 72, p. 109.

45 Acts 43rd Leg., R.S. 1933, ch. 192, sec. 20, p. 592.

Still another amendment was passed in 1935. It extended the $25,000 exemption and low class A rates to gifts to direct lineal descendants of adopted children and step-children of the decedent. Until that time, children of adopted children and step-children of the decedent were taxed as class E beneficiaries.

Multiple Death Taxation

When a large number of the states had enacted inheritance or death taxes, the possibility that more than one state would levy a tax on the same property interests that passed upon death began to become a troublesome practical problem to taxpayers. During the early 1920's, this began to emerge as an urgent matter. Instances of taxing transfers of tangible personal property at death by both the state of decedent's domicile and the state where the property was permanently located at the decedent's death became more frequent. Multiple death taxation of intangibles was even more frequent. For example, corporate stock occasionally was taxed by three states--that of the decedent's domicile, that of the physical presence of the shares--the evidences of the property interest--and that of the company's incorporation. Wisconsin even taxed corporate shares of a non-resident's estate if the corporation owned property in Wisconsin.[46]

Relief from this apparent hardship was sought in the courts and the legislatures. Appeal was made to the federal courts on the ground that a state which exceeded its jurisdiction to tax was depriving the taxpayer of property without due process of law in violation of the 14th Amendment. Precedent for this argument was found in _Union Refrigerator Transit Co. v. Kentucky,_[47] which for the first time found in the 14th Amendment a barrier to certain kinds of double taxation and held it unconstitutional for the state of a corporation's domicile to levy a property tax on tangible personal property permanently located in another state. The single death tax doctrine had its beginnings in 1925 in _Frick v. Pennsylvania,_[48] which held Pennsylvania's attempt to impose a death tax upon property owned by one of its residents but having permanent _situs_ in another state violative of the due process guarantees. It was declared that only one state could tax -- the state where the tangible personalty had its permanent _situs_. Similarily, money in a safe deposit box was held taxable only by the state in which it was located.[49] Bonds issued by a Minnesota municipal corporation were held not subject to a Minnesota death tax; it was stated that they could be taxed only by the state of the decedent's domicile.[50] In striking down the Wisconsin tax provision mentioned above, the Supreme Court held that the corporation's ownership of property in the state was not a sufficient basis for levying a death tax on the shares of stock.[51]

46 Shultz, American Public Finance, _op. cit._, p. 426.
47 199 U.S. 194 (1905).
48 268 U.S. 603 (1925).
49 _Blodgett v. Silberman,_ 227 U.S. 1(1928); _Baldwin v. Missouri,_ 281 U.S. 586 (1930).
50 _Farmers Loan & Trust Co. v. Minnesota,_ 280 U.S. 204 (1930); 18 Calif. L. Rev. 345 (1930).
51 _Rhode Island Hospital Trust Co. v. Doughton,_ 270 U.S. 69 (1926).

A further attack upon the problem of multiple death taxation of intangibles was made by the Supreme Court in 1932. The effort to delineate a single taxable situs was continued. The court held that shares of stock were not taxable by the state of incorporation but were taxable by the state of the decedent's domicile; it also indicated that mere presence of the certificates in a state was not sufficient basis for that state to impose a death tax upon their transfer.[52] This decision was viewed as settling that intangibles were subject to death taxes only in the state of domicile of the owner.

By the mid-1930's, commentators were concluding that the problem of multiple death taxation, if not all multiple property taxation, had been solved through the decisions of the Supreme Court.[53] Realty and tangible personalty were taxable only by the state in which they were located; and intangibles, including stocks, bonds, notes, and bank credits, were believed to be taxable only by the state of the decedent's domicile.[54]

Concurrently with the working out of a judicial solution, the state legislatures had given their attention to this problem, too. They sought to alleviate the situation by providing for reciprocal exemption of intangible property of non-resident decedents. In substance, these acts provided that the state would not levy a death tax upon a non-resident's intangibles located in the state if the state of his domicile granted a similar exemption to the domiciliaries of the first state.[55] By 1932, 39 of the 47 states levying death taxes had enacted such provisions.

However, the single death tax doctrine, which had not been established by the Supreme Court without dissent, was to have a short life, at least so far as intangible property was concerned. In two 1939 cases, the Supreme Court of the United States held that intangible personal property could be taxed by both the state of the decedent's domicile and the state in which it was located or deposited.[56] The court viewed taxation as but a means of distributing the cost of government among those who are subject to its control and who enjoy the protection of its laws. Intangibles, as distinguished from physical things, are but relationships between persons which the law recognizes and lends its courts to enforce. When a person extends his activities concerning his intangibles to states other than his domicile, he avails himself of the benefits and protection of the other state or states. In such case, protection, benefit, and power over the subject matter are not confined to either state.

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52 First National Bank of Boston v. Maine, 284 U.S. 312 (1932).

53 Brown, Multiple Taxation by the States, 48 Harv. L. Rev. 407, 430-432 (1935).

54 Shultz, American Public Finance, op. cit., p. 427.

55 Ibid., pp. 426, 427.

56 Curry v. McCanless, 307 U.S. 357 (1939); Graves v. Elliott, 307 U.S. 383 (1939).

Mr. Justice Stone declared:

> We find it impossible to say that taxation of intangibles can be reduced in every case to the mere mechanical operation of locating at a single place, and there taxing, every legal interest growing out of all the complex legal relationships which may be entered into between persons. ...The Fourteenth Amendment cannot be carried out with such mechanical nicety without infringing powers which we think have not yet been withdrawn from the states.[57]

The single death tax doctrine received another blow in 1942 when the Supreme Court held that a transfer on death of corporate stocks could be taxed by the state of incorporation as well as that of the domicile of the decedent.[58] These decisions have raised serious doubts concerning the standing of Frick v. Pennsylvania. It has been argued that the state of the domicile is not prevented by the 14th Amendment from taxing the tangible personal property of resident decedent, wherever it may be located.[59]

Thus, after coping with the problem of multiple death taxation for about 20 years, the Supreme Court has apparently reached the position that the search for a single tax situs, at least for intangibles, is a search for a mirage, that it cannot be accomplished without creating as many tax injustices as it would avoid, and that such an effort is an unjustified interference with the sovereignty of the several states. The apparent conclusion is that relief must be found in the legislative halls.[60] And all but four or five states have enacted reciprocal exemption provisions; this does much to eliminate multiple taxation.[61] Texas has such a provision.[62]

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57 Curry v. McCanless, 307 U.S. 357,373 (1939).

58 State Tax Commission of Utah v. Aldrich, 316 U.S. 174 (1942). 41 Mich. L. Rev. 351 (1942) considered this case as marking the end of the Supreme Court's effort to use the 14th Amendment to settle the conflicting claims of the states of the domicile of the creditor and of the debtor to tax the transfer of intangible property.

59 Bittker, The Taxation of Out-of-State Tangible Property, 56 Yale L. J. 640 (1947). For a good review of the entire problem, see Guterman, Revitalization of Multiple State Death Taxation, 42 Col. L. Rev. 1249 (1942).

60 Groves, op. cit., p. 240. Mr. Justice Holmes suggested as much in his dissent in Union Refrigerator Transit Co. v. Kentucky, 199 U.S. 194, 211 (1905).

61 Report of California Legislature, op. cit., p. 463.

62 Tex. Civ. Stat. (Vernon, 1948) art. 7117.

The legislation and the judicial decisions outlined here have dealt with the problem of which state has the jurisdiction or power to tax after the facts concerning domicile of the decedent and location of the property have been established. However, multiple taxation can also result from contradictory finding of facts upon which the rule embodied in the reciprocal exemption statutes or decisions depend for their operation. A dramatic example of this is the case of the estate of Dr. John T. Dorrance, founder of the Campbell Soup Company. In his later years, he established homes in both New Jersey and Pennsylvania. After his death, both states found that he was domiciled in them at his death, and both levied death taxes upon his estate upon that basis. Courts of both states recognized the universal American rule that a person can have but one domicile at a given time; they disagreed on the conclusion of fact to be drawn from the evidence. The Supreme Court refused to review the case on the grounds that it had no jurisdiction.[63]

When Col. Edward H. R. Green died, Texas, Florida, New York, and Massachusetts found that he was domiciled in them at his death and levied death taxes upon the estate. Claims of the four states and the United States for death taxes exceeded the total value of the estate. Texas brought suit in the United States Supreme Court against the other three states to get a determination of domicile. Upon the basis that this was a controversy between two or more states, the Supreme Court, in Texas v. Florida, found it had jurisdiction and determined that Col. Green was domiciled in Massachusetts upon his death.[64]

It may be seen, then, that the estate of the wealthy nomad may be subjected to taxation by more than one state because of independent and conflicting findings as to domicile at death. Except in unusual circumstances, there is no judicial remedy in these infrequent cases. However, the legislatures have also dealt with this problem. Some states have authorized their tax administrators to compromise such cases with tax administrators of the other state or states; and if this fails, they may submit the question of domicile to a board of arbiters for the finding of a single domicile.[65]

Texas Adopts the Reciprocal Exemption in 1929.

While the Supreme Court of the United States was developing the single taxable situs theory, Texas in 1929 fell in line with many of the other states and sought to remedy the problem of multiple taxation of intangible property, at least partially, by the adoption of a reciprocal exemption provision. The provision stated that Texas would exempt the intangible property, located in Texas of a non-

63 Dorrance v. Pennsylvania, 287 U.S. 660 (1932); see also Dorrance's Estate, 309 Pa. 151 (1932) and In re Dorrance, 115 N.J. Eq. 268 (1934). Technically, a person can have only one domicile. Restatement, Conflicts of Laws, American Law Institute, 1934, § 11.

64 Texas v. Florida, 306 U.S. 398 (1939).

65 56 Harv. L. Rev. 482 (1942).

resident decedent who at the time of his death resided in a state, territory of the United States, or of a foreign country which did not impose a transfer or inheritance tax on intangible personal property of Texas residents, or if the State, territory, or foreign country where the decedent resided at his death had a reciprocal exemption provision exempting intangible personal property of non-resident decedents.[66] The emergency clause of the amendment recites that the act was passed so that citizens of Texas who owned securities in states which had reciprocal provisions could take advantage of such exemptions.

As stated above, in 1939, the Supreme Court held that intangible personal property was taxable in at least two states -- in that where located and in that where the owner - decedent was domiciled. This marked the end of the single death tax doctrine. In the same year, Texas abandoned the reciprocal exemption provision.[67] No reason for the abandonment is apparent from a reading of the amendment. However, in 1945, when the single taxable situs theory as applied to intangible personal property had already been completely broken down, the Texas legislature restored the reciprocal exemption to the Texas inheritance tax law.[68] The 1945 provision was a re-enactment of the 1929 provision except that it was inapplicable to residents of foreign countries.

Texas Takes Advantage of the Federal Credit in 1933

Although federal credit was first allowed in 1924 to the extent of 25 per cent and raised to 80 per cent in 1926, Texas did not take full advantage of the credit until 1933.[69] The law is entitled "Additional Inheritance Taxes" and appears under Title 122, Chapter 5A, Article 7144a of Vernon's Civil Statutes. The additional tax is commonly referred to as "chapter 5A". It establishes no system of rates or exemptions; it merely provides, as did the New York Act, that if the amount of tax levied by Texas under chapter 5 does not equal or exceed the 80 per cent federal credit, then a tax is levied in an amount which when added to the taxes levied under chapter 5 will equal the 80 per cent credit. The taxes levied under chapter 5A are never construed to increase the total amount of taxes payable to the federal and state governments.

The additional inheritance tax also provided that administration was to be handled by the same officials who administered the inheritance tax, that the federal valuation of the estate be considered, and that banks and safe deposit companies, as well as county clerks, give the Comptroller notice with respect to decedents' estates.

66 Acts 41st Leg., 1st C.S. 1929, ch. 50, p. 109.
67 Acts 46th Leg., R.S. 1939, ch. 13, p. 646.
68 Acts 49th Leg., R.S. 1945, ch. 98, p. 148.
69 Acts 43rd Leg., R. S. 1933, ch. 192, sec. 2b, p. 585; 22 Tex. L. Rev. 93 (1943).

Coverage Problems and the Gift Tax

In the early days of inheritance taxation, problems centered for the most part around administrative difficulties. These problems were accompanied by the not entirely unrelated problem of avoidance of the tax, which by 1908 had already become acute.[70] Four major aspects of the coverage problem are: (1) transfers to take effect in possession and enjoyment at or after death, (2) gifts made before death, (3) transfers made under the exercise of powers of appointment, and (4) transfers by virtue of survivorship. An understanding of some of these problems gives a clue to the reason for the several 1939 amendments to the Texas act.

The Pennsylvania act of 1826, which represented the first inheritance taxation in the United States, dealt with the problem of coverage by incorporating a sweeping provision taxing "transfers to take effect in possession and enjoyment at or after death." Today this provision has gained such wide acceptance that the federal statute and all the state statutes except that of Louisiana have it in their death tax laws.[71] The provision is especially designed to cover transfers made by the decedent before his death where he retains a life estate or where he creates a trust and retains the power of revocation.

The first real avoidance problems created in the administration of inheritance taxes arose out of *inter vivos* gifts -- gifts made by the decedent before his death. The early inheritance tax laws, it seems, did not even cover gifts *causa mortis*, i. e., deathbed gifts. A gift *causa mortis* is a type of *inter vivos* gift, but it must have been made in anticipation of a speedy death from a present sickness or impending peril.[72] New York, in 1891, was the first state to find a partial solution to the problem of *inter vivos* gifts in the enactment of a provision covering "gifts made in contemplation of death."[73] At first the provision was not as effective as might be imagined, for in New York and in most other jurisdictions which adopted it, it was limited to gifts *causa mortis* and did not cover other *inter vivos* gifts made in contemplation of death if there was no anticipation of a speedy death from a present sickness.

Remedies for the limited effectiveness of the provision were sought by attaching to it two types of presumptions. First, the Wisconsin legislature in 1913 enacted a law specifying that gifts made by the decedent within six years preceding his death were presumed to have been in contemplation of death.[74] The effect of the law was to create a *prima facie* or rebuttable presumption that the gifts made within six years were made in contemplation of death, hence placing the burden of proving the contrary on the estate. This did not work as well as had been anticipated, since the estate was usually in a favorable position

70 Shultz, *The Taxation of Inheritance*, *op. cit.*, pp. 121, 123.

71 "Inheritance, Estate, and Gift Tax Service, State," *op. cit.*, p. 80-191.

72 American Jurisprudence, § 14.

73 Shultz, op. cit., *The Taxation of Inheritance*, pp. 112, 113.

74 Shultz, *The Taxation of Inheritance*, p. 140.

to gather evidence and overcome the presumption. On the other hand, usually, the state could only show that the decedent had reached a very advanced age at the time he made the gift and that for that reason the gift was in contemplation of death. The courts generally held, however, that old age in itself was insufficient to establish that the gift was made in contemplation of death. In 1915, because the rebuttable presumption provision was not accomplishing what had been expected, the Wisconsin legislature again sought to reach a greater number of _inter vivos_ gifts by the enactment of a provision that gifts made by the decedent within six years prior to his death were _conclusively presumed_ to have been in contemplation of death. The effect of such a provision was to create a rule of law that if the gift were made within the six year period it was subject to the death tax. No proof, however strong, would be received to overcome the presumption. The Supreme Court of the United States held the law unconstitutional because it violated the 14th Amendment.[75] Likewise, a federal statute seeking to create a conclusive presumption that gifts made within two years of death were in contemplation of death was held unconstitutional in violation of the 5th Amendment.[76]

Today all states tax gifts made in contemplation of death. Most of them also specify periods within which gifts create a _prima facie_ or rebuttable presumption that they were made in contemplation of death. The statutory periods vary from six months to five years before the death of the decedent, with two years the most popular period.[77]

Further problems of avoiding the early inheritance tax laws were presented by utilization of powers of appointment. A power of appointment is the authority conferred by one person (the donor) upon another (the donee) to dispose of the property of the former or to appoint takers (appointees) of the property. The avoidance usually consisted of the decedent's giving to a designated person (the donee) an estate for life in certain property (i.e., the right to the use of the property for a period measured by the donee's life) with the power to appoint his successor. According to traditional real property concepts, the successor (appointee), though designated in the donee's will, inherits from the donor rather than from the donee. Hence when the donee of the power exercises the power of appointment by designating his successor, no taxable transfer occurred, since the transfer is not from the donee. As early as 1897, New York remedied the situation by providing expressly for the taxation of transfers made under exercise of powers of appointment.[78] Today such transfers are taxable in all but three states levying death taxes -- Connecticut, Indiana, and Louisiana.[79]

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75 _Schelsinger_ v. _Wisconsin_, 270 U.S. 230 (1926); see Groves, _op. cit._, p.243.
76 _Heiner_ v. _Donnan_, 285 U.S. 312 (1932).
77 "Inheritance, Estate, and Gift Tax Service, State," _op. cit._, p. 81-039.
78 Shultz, _The Taxation of Inheritance_, _op. cit._, p. 119.
79 "Inheritance, Estate, and Gift Tax Service, State," _op. cit._, p. 81-029.

Another method of avoiding inheritance tax laws was the creation of joint interests with the right of survivorship, i. e., upon the death of one of the owners, the property passed to the surviving joint owner or owners. Since the inheritance tax laws usually taxed only receipt of property by will or intestate succession (statutory provisions governing the distribution of property where the decedent has left no will), the receipt of property by virtue of the right of survivorship was not covered. This situation led to the adoption of provisions taxing transfers by survivorship, first by West Virginia in 1907, and by most of the other states after 1915.[80] Texas, however, has no such provision.

Avoidance of death taxes still creates a problem today. The _inter vivos_ gift which the legislatures of New York and Wisconsin sought to bring within the scope of their laws remains the primary method of avoiding most state death taxes.[81] Though the problem was alleviated somewhat by the _prima facie_ presumption provision, a large number of _inter vivos_ gifts serving substantially the same purpose for the donor as gifts upon his death are untaxed.[82] The first effective solution to the problem was found by the federal government in 1924 (the year of the 25 per cent federal credit provision) in the enactment of a gift tax -- a tax on _inter vivos_ gifts not covered by the estate tax. The 1924 gift tax, by its exemptions, still permitted many gifts to go untaxed. Because of strong sentiment against it, the tax was repealed in 1926.[83] In 1932, our present federal gift tax was enacted. Its primary purpose is to check the avoidance of death taxes by _inter vivos_ gifts and not to yield revenue, although a considerable amount is collected in some instances. Since the adoption of the federal gift tax, 12 states have enacted similar taxes to supplement death taxes. Texas levies no gift tax.

The above discussion shows briefly how some of the more important coverage problems have been met. It should be noted that the coverage provisions did not receive immediate adoption by all the states. This fact is illustrated by the absence of provisions taxing _inter vivos_ gifts in laws of three-fourths of the states today.

Texas Deals with Coverage Problems -- The Amendment of 1939.

The Texas Legislature was not among the first to adopt the coverage provisions discussed above. The Pennsylvania clause taxing "transfers to take effect in possession and enjoyment at or after death" was incorporated into the Texas inheritance act of 1907. But it was not until 1939 that an amendment taxing transfers under a power of appointment and gifts in contemplation of death was adopted.[84]

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80 Shultz, _The Taxation of Inheritance_, _op. cit._, p. 141.
81 Groves, _op. cit._, p. 242.
82 _Ibid._
83 Shultz, _American Public Finance_, p. 444.
84 Acts 46th Leg., R.S. 1939, ch. 13, p. 646.

Concerning powers of appointment, the amendment provided for taxation of transfers made under the exercise of general power of appointment exercised by the decedent by will. (A general power of appointment is such that for all practical purposes the donee of the power has been given outright ownership of the property. If the donee has a general power, he is not limited in his choice of appointees, which distinguishes the general power from a special power of appointment.)

Transfers made in contemplation of death without adequate consideration were made taxable. In connection with the contemplation of death provision, a rebuttable presumption was created that gifts made within two years prior to the death of the decedent were in contemplation of death.

The amendment also provided for the first time for taxation of proceeds of insurance policies. A $40,000 exemption apparently became part of the Texas law through adoption of a similar provision which at that time appeared in the federal estate tax but which was repealed in 1942.

The 1939 amendment further enlarged the permissible deductions by allowing attorneys' fees and court costs in connection with the assessment of inheritance taxes. And it provided for judicial review of the appraisal.

Further Shift of Administration From the Local Level

In 1943, an earlier provision requiring the county clerk to report to the Comptroller was amended to require representatives of estates to first file a report with the county clerk, who was then required to forward information to the Comptroller.[85]

A 1945 amendment, providing that inheritance taxes be paid to the State Treasurer through the Comptroller instead of to the county tax collector,[86] removed from the hands of the county officials probably the most significant of their remaining administrative duties. As noted above, much of the responsibility for enforcement of the tax was transferred to the Comptroller by an amendment in 1917. The new act in 1923 retained this provision and, it seems, even increased the Comptroller's responsibility in some respects.

In the history of Texas inheritance taxation shows a complete transition from local enforcement to enforcement emanating primarily from the Comptroller. It shows a transition from the collateral inheritance tax to a tax which taxes direct heirs as well as collateral heirs. Collection records indicate that the tax, which in its early years produced an average of only $32,700

85 Acts 48th Leg., R.S. 1943, ch. 250, p. 374; Tex. Pen. Code (Vernon, 1948) art. 107a.

86 Acts 49th Leg. R.S. 1945, ch. 332, sec. 2, p. 546.

annually, produced more than $5,000,000 in 1951. It has averaged that amount since 1948.

Present-day Death Tax Trends in the United States

Developments during the last 35 years (since the federal estate tax in 1916) seem to indicate that at least two trends in state death taxation have been begun by the federal government -- (1) the use of the estate-type death tax instead of the inheritance type and (2) the use of gift taxes to eliminate the principal method of death tax avoidance. There is some indication of even another trend -- that of endeavoring to make state death tax laws conform to the federal estate tax to enable state administrative officials to take advantage of the wealth of federal administrative rulings.[87]

It is impossible to say whether most of the states will exchange their inheritance taxes for estate taxes or whether they will rewrite them otherwise to conform to the federal tax. As a matter of practical necessity, it seems that a greater number may adopt gift taxes.

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87 Commerce Clearing House, The Tax Magazine, vol. 29, no. 3 (March, 1951), p. 226.

SECTION 2 - ORGANIZATIONAL FORM

General

Death taxation in the United States is accomplished through two different kinds of taxing statutes -- the inheritance tax and the estate tax. Most of the states which levied succession taxes before 1926 have enacted additional taxes to the extent of the difference between the then-existing taxes and the federal credit discussed in Section 1. These additional taxes permitted the states to take full advantage of the federal credit, set at 25 per cent in 1926 and later increased to 80 per cent. In recent years, the trend has been to impose gift taxes to supplement both inheritance and estate taxes.

The inheritance tax, as levied by 37 states, is an excise tax. The occasion for its imposition is the receipt of the property by the heir or beneficiary. Hence the tax is a payment by the heir or beneficiary for the privilege of receiving property, either by will or by virtue of the laws governing intestate succession.

The amount of the tax is dependent upon the value of the property received by the individual heir or beneficiary, and a lien is imposed upon his share to secure payment of the tax.

The additional tax usually imposed with the inheritance levy to take full advantage of the federal credit allowance is also an excise tax. This and the inheritance tax are usually administered by the same officials or agency. Most statutes provide for administration by a state department or agency, but a few leave the responsibility with local officials.

The estate tax, imposed by the federal government and by ten states, is also an excise levy. However, there is a distinction between the estate tax and the inheritance tax The former is a tax on the transfer of the property by the decedent and the latter on the receipt of the property by the heir or beneficiary. The estate tax is levied against the net estate of the decedent instead of against the share of the heirs or beneficiaries and is payable out of the residue of the estate -- the part which remains after all the testator's liabilities have been discharged and the particular gifts in the will carried into effect.

The decedent's estate pays the tax rather than the individual beneficiaries. Some states, however, have modified the pure form of the estate tax and approximated it to the inheritance tax by providing that the tax is to be assessed pro rata against the beneficiaries. Like the inheritance tax, the levy on estates is usually administered by a state department or agency.

Gift taxes, presently used by 12 states and the federal government, are also excise taxes. Usually the gift tax is administered in the same manner and by the same persons who administer death taxes.

Texas imposes the inheritance-type death tax and the additional inheritance tax to take full advantage of the 80-per-cent federal credit, but it does not supplement these with a gift tax. The two Texas statutes provide, in effect, that they are to be administered by the same persons and are to be collected and enforced according to the same law.[88]

Divided Administration

The Comptroller bears the greatest responsibility for the tax; but a number of other state and local officials assist in the administration. Unlike other major state taxes, death taxes are often administered by various combinations of state and local lay and judicial agencies. Instead of being administered by a single agency like sales and income taxes, for example, death taxes are often administered by a series of agencies.[89]

In the case of Texas, neither the inheritance nor the additional tax clearly specifies an administrative organization. However, both indicate an intent that the Comptroller of Public Accounts be primarily responsible for administration. Important records concerning the taxes are required to be filed with the Comptroller for his evaluation; taxes are payable through him to the State Treasurer; he is required to refund excess taxes collected and give receipts; and he is responsible for furnishing all the forms necessary for collection of the taxes.

Administrative responsibility for the tax is now vested in the Inheritance Tax Division of the Comptroller's Office.

The State Treasurer, designated by statute to receive the tax payments from the Comptroller, has no other administrative function related to the Texas death tax.

By making legal interpretations and defending suits against the State for recovery of taxes paid under protest, the Attorney General performs a valuable service in the administration of these taxes. Although the tax statutes do not specifically provide that he perform these functions, authority for them may be found elsewhere.[90] A provision in the original 1923 act pertaining to the appointment of an inheritance tax attorney by the Attorney General within his department to advise the Comptroller was omitted from the

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[88] Tex. Civ. Stat. (Vernon, 1948) art. 7144a, sec. 7.

[89] Walter W. Heller and C. Lowell Harriss, The Administration of State Death Taxes, 26 Iowa L. Rev. 628 (1941).

[90] Tex. Civ. Stat. (Vernon, 1948) arts. 4399 and 7057b.

1925 revision.[91]

It appears that the Attorney General, through his opinions and his representation of the state in inheritance tax suits, determines to a considerable degree the course of administrative action to be followed by the Comptroller. His numerous opinions concerning the inheritance and additional taxes are evidence of his important position.

In addition to the three above-named state officials, certain local officers assist in the administration of the taxes. Chief among these are the county judge, the county attorney, and the county clerk.

The statute gives the county judge a very important position insofar as assessment of the taxes is concerned. It provides that the order fixing the amount of inheritance taxes due must be signed by him as well as by the Comptroller. Thus the county judge may refuse to approve any appraisal of property which he believes incorrect or in which he does not concur, even though the appraisal might have been made by a field examiner from the Inheritance Tax Division of the Comptroller's Office. There have been instances in which a representative or attorney of an estate has asked the county judge not to approve the appraisal made by the field examiner. The county judge, then, has a place of considerable importance in the administration of the state's inheritance tax.

In addition, the county judge is also the probate judge and is probably the best-informed local official concerning value of the estate and the shares to be received by beneficiaries. For that reason, he is in a position to offer useful information to the Comptroller.

The county attorney is designated by statute to file suit to enforce the lien imposed on the property received by a particular heir or beneficiary if the inheritance and additional taxes are not paid.[92] An attitude of unconcern seems common among county attorneys concerning enforcement of liens. Since most beneficiaries pay the taxes without threat of foreclosure, however, the amount of taxes lost by this indifference is inconsequential.

The county clerk aids in administering the law by informing the Comptroller of estates admitted to probate and by giving other information requested by the Comptroller.[93]

In addition, administrators and executors of estates are given a number of duties by the statute, most important of which is filing reports. Legally, they are officers of the probate court. Every executor, administrator, or

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91 Acts 38th Leg., 2d C. S. 1923, ch. 29, sec. 25, p. 63.

92 Tex. Civ. Stat. (Vernon, 1948) art. 7134.

93 Tex. Pen. Code (Vernon, 1948) art. 107a.

trustee of the estate of a decedent leaving property subject to tax must file a preliminary report within 30 days after qualifying as executor, administrator or trustee. One copy goes to the Comptroller and the other to the county clerk of the county in which the decedent resided at the time of his death or in which the principal part of the estate is located. The report must give the date of decedent's death, the character and approximate value of his estate, and the persons and relationship entitled to receive the estate. A final and detailed report must be filed within six months after the executor, administrator, or trustee has qualified.[94]

In practice, administrative functions are probably not as divided as this discussion would make them appear. There is sufficient division, however, to prevent a centralized administrative organization.

Inheritance Tax Division

The Inheritance Tax Division of the Comptroller's Office was organized in 1925. Since that time, it has been the administrative body responsible for the inheritance tax. The division now has 14 employees -- seven in the office and seven in the field. The field force of inheritance tax examiners is assigned the task of ascertaining the accuracy of information submitted in reports of estate representatives. Each examiner operates within a specific district or area of the state.

The office force includes the inheritance tax officer, who is director of the division. Office personnel process returns filed by representatives of estates and keep permanent files on all estates of which they have knowledge.

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94 Tex. Civ. Stat. (Vernon, 1948) art. 7126.

SECTION 3 - ASSESSMENT

General

Although the inheritance tax and the additional inheritance tax are both administered principally by the Inheritance Tax Division of the Comptroller's Office, the methods for assessing the two taxes differ considerably and so will be discussed separately.

The Texas inheritance tax is a tax on the right of the heirs or beneficiaries to receive property by will or by the laws of intestate succession.[95] The amount of the tax is computed separately for each heir or beneficiary by applying the applicable rate to value of the property received by him. The tax rate is based on the value of the property received by a particular heir or beneficiary and upon the degree of his relationship to the decedent. Thus, the greater the value of the property the higher the tax rate, and the more distant the relationship of recipient to the decedent, the higher the rate.

A number of relevant inquiries are made in assessing the inheritance tax. These concern determinations of (1) the type and location of property received by the heir or beneficiary, (2) the means by which the property was transferred to him, (3) the permitted deductions, (4) the permitted exemptions, and (5) the applicable rates. The latter two factors are determined largely by the relationship of the heir or beneficiary to the decedent.

Property Subject to the Tax

Since the inheritance tax is computed on the value of property received by the heir or beneficiary, the first task in determining the amount of tax due is to ascertain what property is included. The first sentence of the inheritance tax law simply states that "all property within the jurisdiction of this State, real or personal, corporate or incorporate, and any interest therein. . ." is subject to the tax, "regardless of whether such property is located within or without this State."[96] If "jurisdiction" is used in its customary sense of power, the law seems to subject to the tax all property which Texas has the power to tax. The answer to specific questions would then seem to have to be found in the constitution as interpreted, and ultimately as interpreted by the Supreme Court of the United States.

The problem of determining what property is subject to the Texas death tax in a particular case is a simple matter in a number of instances. If the decedent were domiciled in Texas at his death and all his property -- real, tangible personal, and intangible personal -- were located in the state at his death, then all

95 See Bethea v. Sheppard, 143 S.W.2d 997 (Tex. Civ. App.,) 1940, error ref'd.; Norton v. Jones, 210 S.W. 2d 820 (Tex. Civ. App., 1948), error ref'd.

96 Tex. Civ. Stat. (Vernon, 1948) art. 7117. "Corporate or incorporate" was probably intended to be "corporeal or incorporeal."

the decedent's property is taken into account in determining the tax due. However, if the resident decedent owned tangible personal property which was permanently located in another state at his death, a question arises as to whether Texas may tax the property. Although the Texas statute provides that all property within the jurisdiction of the state, whether located within or without Texas, is subject to the tax, the Frick v. Pennsylvania[97] decision seems to dictate that Texas cannot and does not tax the out-of-state tangible personal property of a Texas resident decedent.[98]

If the decedent was domiciled in Texas at his death, it seems that all of his intangible personal property wherever located is subject to the state death tax.[99] As was explained in Section I of this chapter, intangible personal property may be subjected to a death tax by more than one state. But apparently under the co-operative effort of the state legislatures in enacting the reciprocal exemption provisions, it seems that in this case the state of domicile--Texas -- would tax all the decedent's intangible personal property and that no other state would. Of course, if some of the intangibles were located in or had some other connection with a state not employing this exemption provision, the intangibles would be taxed by both Texas and such other state.

Where the decedent was domiciled in some state other than Texas at his death but owned property located in Texas at that time, a different circumstance arises. If the property were real property or personal property permanently situated in the state, then it would be subject to the inheritance tax. If the non-resident's property were intangible having a permanent location or business situs in the State, then it is subject to the Texas tax. However, as such property will also be taxed by state of the non-resident's domicile, the reciprocal exemption provision of the Texas law would come into play. It provides that if this non-resident lived in a state exempting from its death tax the intangibles of decedents not domiciled there, this non-resident's intangibles which are located in Texas are exempt from the Texas inheritance tax.[100] Briefly then, the intangibles located in the state owned by non-resident decedents are not taxed in most cases under the Texas inheritance tax.

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[97] 268 U.S. 473 (1925).

[98] However, it has been contended that the Frick case is now of doubtful vitality and that the state of the decedent's domicile is not prevented by the 14th Amendment from taxing tangible personalty of the decedent permanently located outside the state. See the discussion in Section 1 of this chapter. If the interpretation of the Texas act set out above is correct and the analyses of Bittker and Guterman are sound, then such property is subject to the Texas inheritance tax.

[99] Curry v. McCanless, 307 U.S. 357 (1939); Graves v. Elliott, 307 U.S. 383 (1939).

[100] Tex. Civ. Stat. (Vernon, 1948) art. 7117.

Texas is a community property state and not a common law property state. This means that there are certain special differences in the application of our inheritance tax. Because community property concepts declare that each spouse owns one-half of the community property, only one-half of the community property is subject to the inheritance tax. For example, if the husband died possessing only a community estate worth $100,000, and left all to his wife, one-half of the community--$50,000--would not be considered for inheritance tax purposes because it represents the wife's share of the community. As to the remaining half, the wife would take as beneficiary under the will and so it would be subject to the tax; however, as a class "A" beneficiary, she would be entitled to an exemption of $25,000. Thus she would be subject to a tax on $25,000 ($50,000 minus $25,000 exemption equals $25,000)

Even if the husband leaves his wife specific property by his will in lieu of her community interest, it has been held that although the wife took the specific property under the will instead of claiming her one-half undivided interest in the community property, the property she received is not taxable.[101] Of course, if the husband leaves his wife more than her share of the community property and if the portion representing the husband's share exceeds $25,000 (the exemption permitted for gifts to a surviving spouse), she incurs an ineritance tax on such excess.

One other type of property--United States War Bonds--deserves particular attention here. War bonds payable to named beneficiaries at the death of the decedent and co-ownership war bonds are both included in computing the inheritance tax. Although the federal government has often provided that certain obligations are not to be taxed, these exemptions do not apply to an inheritance tax levied on the right to receive the property and not on the obligations themselves.[102]

<u>Tranfers Subject to the Tax</u>

Another task which must be performed before the rates may be applied and the tax computed is to determine which transfers of property by the decedent are subject to the inheritance tax. As the Texas death tax is an inheritance tax and applicable to the <u>receipt</u> and not the <u>transfer</u> of property, it would seem more accurate to state the problem in terms of the receipt of property as a result of the kinds of transfers subject to the tax. However, probably influenced by the terminology developed with regard to the estate tax, the question is customarily framed in terms of determining whether the transaction is a "taxable transfer" or a "transfer subject to the tax."

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[101] Jones v. State, 5 S.W. 2d 973 (Tex. Comm. App., 1928).

[102] Op. Tex. Atty. Gen. No. 0-7495 (December 17, 1946).

The statute specifies five types of taxable transfers: (1) Transfers by will or by virtue of the laws governing intestate distribution, (2) transfers intended to take effect in possession and enjoyment after death, (3) transfers in contemplation of death without adequate consideration, (4) transfers in exercise of a general power of appointment, (5) transfers of the proceeds of life insurance policies.[103] Each type of transfer will be discussed below.

Transfers by Will or Intestate Succession

The receipt of property either by terms of a will or, if no will exists, by virtue of the laws governing distribution of property belonging to intestate decedents is taxable under the Texas act. This means that if the property is such as is tax able under the terms discussed above and if it is disposed of by will or by the laws governing intestate distribution, it is subject to the inheritance tax.

It matters not that the testator or intestate was not a resident of Texas. If he owned real or personal property within the state and it was transferred to another person by will or the laws governing intestate succession, the Texas inheritance tax is levied on receipt of the property. It has been held that even if a creditor is given a legacy in satisfaction of the debt owed him, the amount he receives is still taxable, since the law specifically taxes "all property . . . which shall pass . . . by will. . . ."[104] Of course, the creditor can avoid the tax by renouncing the legacy and collecting his claim as a debt against the estate.

If the will is probated under a compromise settlement--if the will is contested and the contestant is given a share of the estate in satisfaction of his contention--the inheritance tax is computed by using the terms of the will, regardless of the amounts paid under the compromise.[105]

Transfers Intended to Take Effect in Possession and Enjoyment after Death

The Texas inheritance tax act does not define the above phrase; however, it is used in the federal act and in all state death tax laws. It is designed to reach those gifts of property made by the decedent during his life under which the interest given does not mature into the right of immediate possession and enjoyment until after the donor-decedent's death. It was apparently felt that such a gift during the life of the decedent served the same purpose as a gift at death and so should be treated the same for tax purposes.

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[103] Tex. Civ. Stat. (Vernon, 1948) art. 7117.

[104] Sheppard v. Desmond 169 S.W. 2d 788 (Tex. Civ. App., 1943).

[105] Crane v. Mann, 162 S.W. 2d 117 (Tex. Civ. App., 1942, error ref'd).

The concept of this provision may be illustrated by an example. Father owns a farm which he wants his daughter to have after he dies. He can accomplish this object in two ways. He can make a will to that effect. Or he can transfer the farm to her during his life and reserve a life estate in the farm for himself. If he follows the second route, he has conveyed a present interest in the farm during his life; his daughter obtains what is called a remainder. The remainder is a present and vested interest in the farm which the daughter may sell at any time. The father has the full use of the farm throughout his life; however, as he has given the remainder to his daughter, he cannot convey full title to the farm to a purchaser. However, the property interest which the daughter received by this gift in the farm does not permit her to take possession of it and use it until her father's death. Although there are clear property distinctions and certain practical differences between the two transactions, the legislatures apparently felt that there was not such a substantial difference that one should be taxed and the other not taxed.

Where the decedent has made a gift during his lifetime but has retained such an interest in the property given that the donee is not unconditionally entitled to its enjoyment and possession until after the donor's death, the receipt by the donee in such a transfer is subject to the inheritance tax. The reservation by the donor for his lifetime of the use, management, possession, or any beneficial interest whatever subjects the gift to the inheritance tax.[106] The Attorney General has interpreted the law to mean that if either the possession or enjoyment is contingent upon the donor's death, the transfer is taxable upon his death.[107]

Another illustration of thr transfers covered by this provision is the case where the decedent deposited money in a joint bank account for herself and her daughter. At death of either, the balance was to go to the survivor. The amount left in the bank at the death of the mother was declared to be a transfer intended to take effect in possession and enjoyment after her death and as such subject to the tax.[108]

Transfers in Contemplation of Death

This class of transfers is another which is different according to traditional property law concepts from a transfer resulting from will or intestate succession but which is apparently considered so like a gift by will or intestate in purpose and substance by the legislatures that they are both treated the same for death tax purposes. The Texas law taxes any transfer by "deed, grant, sale or gift" made in contemplation of death. The only transfers subject to the tax are those made as gifts. "Sale" is included to cover those sales which are

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[106] Comptroller of Public Accounts, Inheritance Tax Division, "Inheritance Tax Laws, State of Texas, 1949," p. 24.

[107] Op. Tex. Atty. Gen. No. 0-5002 (May 5, 1943).

[108] Op. Tex. Atty. Gen. No. 0-2850 (Dec. 18, 1940). The withdrawals made by the daughter during her mother's life were ruled to be completed gifts and hence not taxable.

made without adequate valuable consideration; in other words, a transfer which is in substance a gift but is nominally a sale because the transferor received a nominal or token price for the property is subject to the tax. The transfer under this provision must be of a material part of the vendor or donor's estate.

To aid the administration of the tax, the statute creates a prima facie or rebuttable presumption that all gifts made by the decedent within two years of his death were made in contemplation of death. This means that the donee who received a gift from the decedent within the two-year period has the burden of proving that prospect of death was not the impelling cause for the gift.

The Texas law gives no definition of "transfer in comtemplation of death." The Federal Estate Tax Regulations define it as follows:

> A transfer in contemplation of death is a disposition of property prompted by the thought of death (though it need not be solely so prompted). A transfer is prompted by the thought of death if it is made with the purpose of avoiding the tax, or as a substitute for a testamentary disposition of the property, or for any other motive associated with death. The bodily and mental conditions of the decedent and all other attendant facts and circumstances are to be scrutinized to determine whether or not such thought prompted the disposition.[109]

The federal definition is probably somewhat broader that that applied under the Texas act. It is significant to note that the coverage of the "transfers in contemplation of death" provision under the federal and Texas laws is not limited to gifts causa mortis--that is, deathbed gifts.

It is apparent that it is not an easy or mechanical task to determine whether a particular gift made by the decedent during his life was made in contemplation of death. In addition, the ascertaining of whether decedents made during their lifetimes gifts which may be subject to the inheritance tax is a very difficult administrative and enforcement problem. If the tax return or report lists such gifts, the administrative task is greatly simplified. If a taxable transfer of personal property is made during decedent's lifetime but is not reported in the tax return, it is most difficult to learn of such transfers in the ordinary enforcement routine. If the gift is of real property situated in the county where the estate is being probated, a search of the deed records in the county court house will elicit the information.

[109] Federal Estate Tax Regulations, sec. 81.16.

Transfers Under Powers of Appointment

This again is a class of transfers which, according to strict property concepts, is not the same as the gift by will or laws of descent but which for tax purposes is treated the same. The Texas law provides that transfers of property resulting from the exercise of a general power of appointment by will are taxable upon the death of the recipient of the power.

The substantive similarity of a gift under this class of transfer and the customary one by will may be illustrated by an example. In his will the father gave his wife a life estate in a ranch and gave her the general power to appoint the successor in interest. They had three children. Instead of designating one or all of the children as remaindermen, he chose this method. Among his reasons for choosing this device may have been that granting his wife the full power to dispose of the property would induce the children to show her full respect and attention or that he wished her to designate the child who would, according to circumstances existing some time after his death, be the most needy or deserving. When the wife exercises the power, property law concepts declare that the title to the ranch goes directly from the father to the child designated and not through the wife. Thus, under strict property law, the wife does not grant or convey an interest in the ranch to the person designated. In this illustration, the father is the donor of the power, the wife the donee, and the person designated by the wife is the appointee.

If the donor of the power does not restrict the donee to a certain class of appointees, such as surviving children, in making her appointment, the donee is said to have a general power of appointment. When the persons permitted to take as appointees are limited, the power is designated as special. Where the donee has a general power of appointment, she can of course designate herself; so for all intents and purposes she has full power to deal with the property as if she had full title. Thus, when the donee of the power in the above illustration designates by a provision in her will her youngest daughter as the appointee, she is effecting a transfer of the ranch by will which is no different in substance than if she owned property outright.

The Texas inheritance tax law taxes only the exercise of a general power of appointment by will. Most states tax both the exercise of the power appointment by will and the non-exercise of the power. It is said that a taxable succession takes place when there is a final shifting of economic benefits and burdens of the property upon death and that the non-exercise of a power by the donee may be as much a disposition of property testamentary in nature as its exercise.[110] Texas apparently taxes only the exercise of a general power and not the non-exercise.

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[110] Chase Nat'l. Bank v. United States, 278 U.S. 327, 338 (1929); State v. Brooks, 181 Minn. 262, 232 N.W. 331 (1930).

Transfer of Life Insurance Proceeds

The Texas inheritance tax statute taxes the proceeds of life insurance taken out by the decedent upon his own life. If the proceeds are payable to the decedent's administrator or executor, that is to his estate, then the entire amount is subject to the tax. However, if the proceeds are payable to named beneficiaries, then a special exemption is given and only the amount in excess of $40,000 is subject to the inheritance tax.[111] This exemption is in addition to the exemption to which the beneficiary is entitled whatever the character of the property.

Community property concepts also have an impact upon the computation of the tax on this kind of interest received by the beneficiary. If the insurance policy were bought with community funds, only one-half the proceeds are taxable upon the insured's death, since one-half of what the widow receives was purchased with her share of the community funds. For example, if the husband bought an $80,000 insurance policy upon his life and paid the premiums out of community funds during the marriage, only $40,000--one-half of total--of it would pass at his death from or through him and would then be considered. Applying the $40,000 life insurance exemption to that half would then result in there being no inheritance tax due on the insurance proceeds.[112]

Texas taxes the proceeds of War Risk Insurance.[113] On the other hand, some states give preferential treatment to servicemen. California, for instance, exempts all property transferred by a decedent killed in the armed services if the transfer is to others than distant relatives or strangers.[114]

Transfers by Survivorship Not Covered

The Texas inheritance tax statute has no provision specifically providing that property received by right of survivorship should be included in determining the amount of tax. A right of survivorship is the right of a person to succeed to property by reason of his having survived another person to

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[111] Since this provision was borrowed from the Federal Revenue Act of 1926, the construction placed upon the federal provision is pertinent in interpreting the Texas provision under the borrowed statutes doctrine in statutory construction. This is true even though the provision of the federal act was repealed in 1942. Blackmon v. Hanson, 140 Tex. 536, 169 S.W. 2d 962 (1943).

[112] See Op. Tex. Atty. Gen. No. 0-5211 (May 15, 1943). For an excellent general treatment of life insurance and community property see Huie, Community Property as Applied to Life Insurance, 17 Tex. L. Rev. 121 (1939), 18 Tex. L. Rev. 121 (1940).

[113] "Inheritance Tax Laws, State of Texas," op. cit., p. 24.

[114] Report, Calif. Legislature, Senate Committee, p. 473.

who also had an interest in it.[115] A common case in which the right of survivorship exists is a joint tenancy, which is illustrated by a situation which arose under the Texas inheritance act. Insurance policies on the father's life were assigned by the father jointly to two sons, or to the surviving one. One son died. The Attorney General ruled that the transfer of the deceased son's interest to the surviving son was not subject to the inheritance tax as a transfer to take effect after death nor as a transfer of the proceeds of the life insurance. The Attorney General suggested that a provision similar to 811(e)(1) of the Federal Internal Revenue Code be added to the Texas Act to cover all transfers by survivorship.[116] Section 811(e)(1) of the federal act subjects to the federal estate tax all classes of property, whether real or personal, if the survivor takes the entire interest therein by right of survivorship.

It should be noted that although a Texas statute abolished tenancy by the entirety and joint tenancy[117], both of which are characterized by the right of survivorship, it has been held that the right of survivorship may still be created by grant or devise, just as it existed at common law.[118]

Deductions

The inheritance tax statute sets forth specifically the permitted deductions.[119] They are (1) funeral expenses and expenses of last illness, (2) expense of administration, including executors' or administrators' commissions, attorney fees, and court costs, (3) all federal, state, county, and municipal taxes due at the time of the death of the decedent, and (4) property upon which an inheritance tax has been paid within the last five years.

Debts secured by real estate are not deductible as debts but are deducted from the listed value of the real estate in the appraisal;[120] in substance, real estate is valued on the basis of the decedent's equity in the property.

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[115] Black's Law Dictionary, 3d ed. (1933).

[116] Op. Tex. Atty. Gen. No. V-668 (August 24, 1948). Today, it seems, the only situation in which jointly-held property may be reached by the Texas inheritance tax is one in which the joint owhership was created under such conditions as to come within the provision covering transfers to take effect in possession and enjoyment after death. See Op. Tex. Atty. Gen. No. 0-2850, (December 18, 1940).

[117] Tex. Civ. Stat. (Vernon, 1948) art. 2580.

[118] Chandler v. Kountze, 130 S.W. 2d, 327 (Tex. Civ. App. 1939, error ref'd).

[119] Tex. Civ. Stat. (Vernon, 1948) art. 7125.

[120] "Inheritance, Estate, and Gift Tax Service, State," op. cit., pp. 57, 217, par. 1770.

The statute provides for the deduction of federal, state, county, and municipal taxes due at the time of the decedent's death. This provision has been interpreted as not permitting the deduction of federal estate taxes, since the statute requires the tax to be due at the time of the decedent's death. The federal estate tax is not due until after his death.[121]

The deduction permitted for property on which inheritance taxes have been paid within the last five years also applies to property upon which a previous inheritance tax has been paid to another state.[122]

The Attorney General has held that the constitutional provision in Article VIII, Section la, which exempts the homestead up to $3,000 from all taxation, does not apply to the inheritance levy. The exemption was ruled applicable only to the property tax;[123] hence no deduction is permitted in computing the inheritance tax.

Exemptions--Five Classes of Beneficiaries

The Texas inheritance tax act permits at least three types of exemptions --(1) personal exemptions permitted individual beneficiaries, (2) exemptions for charitable, religious, and educational institutions when the gift is to be used within the state, and (3) the $40,000 exemption on insurance policies payable to named beneficiaries.

The personal exemptions are those allowed each of the five classes of beneficiaries which the act sets up.[124] It has been mentioned that the Texas inheritance tax act sets up five classes of beneficiaries, and the exemptions as well as tax rates vary with the degree to relationship to the decedent. The father, mother, husband, wife, children, or grandchildren are each permitted a $25,000 exemption (class A beneficiaries).

Gifts to the United States to be used within the State of Texas are exempt up to the same amount--$25,000 (class B beneficiary). Brothers, sisters, nephews, and nieces are permitted a $10,000 exemption (class c). Uncles, aunts, and cousins are permitted a $1,000 exemption (class D). The United States, and educational, charitable, and religious organizations whose gifts are not limited to use within Texas and all other beneficiaries are permitted a $500 exemption (class E).

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[121] Letter Op. Tex. Atty. Gen., v. 357, p. 929, July 26, 1934; see Walker v. Mann, 143 S. W. 2d 152 (Tex. Civ. App., 1940), error ref'd.

[122] Op. Tex. Atty. Gen. (August 3, 1934).

[123] Op. Tex. Atty. Gen. (September 22, 1934).

[124] Tex. Civ. Stat. (Vernon, 1948) art. 7118-7122.

Religious, educational, or charitable organizations whose bequests, devises, or gifts are to be used within the state are entirely exempt from the tax.[125] Before a 1933 amendment to the Texas law, exempted gifts to religious, educational, and charitable institutions not only had to be used within Texas but the organization had to be located in this state. If the organization were chartered in another state, even though it was doing business in Texas and although the gift was restricted to use in Texas, it would not qualify for the exemption.[126] Since 1933, a gift is exempt from the tax so long as it is restricted to use within the State of Texas.[127] A mere agreement by the beneficiary promising that the gift will be used within the state is not sufficient. The restriction must appear in the will or instrument creating the gift,[128] or the organization's charter must specifically limit the use of the devise or bequest to the State of Texas.[129] The Attorney General has stated that a bequest to a city is not subject to the inheritance tax, since a city does not come within any of the classes of taxable beneficiaries.[130] Before 1927, gifts to any city, town, or county in Texas or to the State of Texas or to the United States, to be used in Texas, were considered class B. An amendment in that year eliminated from class B all beneficiaries except the United States.[131] The Comptroller, however, continues to classify Texas cities, towns, and counties and the State of Texas as class B.[132]

The $40,000 exemption applicable to insurance policies payable to named beneficiaries has been discussed.

Problems in Classification of Beneficiaries

The Inheritance Tax Division, the Texas courts, and Attorney General have at various times faced the problem of determining which class a particular beneficiary fits into. The classification rule to which the Inheritance Tax Division adheres is to determine first whether a blood-line relationship exists. For instance, although class B beneficiaries include uncles, aunts, and their descendents, an aunt by marriage would not be entitled to the exemption and rates under that class because she had no blood relationship to the decedent. She would be taxed according to the exemption and rates of class E. By the same token, a sister-in-law would not be permitted the exemption and rates of class C, which includes sisters.

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[125]Tex. Civ. Stat. (Vernon, 1948) art. 7122.

[126]San Jacinto National Bank v. Sheppard, 125 S.W. 2d 715 (Tex. Civ. App. 1938).

[127]Acts 43d Leg., R.S. 1933, ch. 192, sec. 20, p. 592.

[128]Presbyterian Church in the U.S. v. Sheppard, 198 S.W. 2d 282 (Tex. Civ. App., 1946); Op. Tex. Atty. Gen. No. V-704 (October 21, 1948).

[129]Op. Tex. Atty. Gen. No. 0-5342 (June 15, 1943).

[130]Op. Tex. Atty. Gen. No. 0-7070 (March 13, 1946).

[131]Acts 40th Leg., R.S. 1927, ch. 62, p. 87.

[132]"Inheritance Tax Laws, State of Texas, 1949," op. cit., p. 22.

Classification of adopted children has also caused some problems. For instance, where the beneficiary lived with the decedent, performed the duties of a son, and was held out by the decedent as her son, the Attorney General ruled that before a transfer to an adopted child could qualify for the class A exemption, the adoption statutes must have been complied with.[133]

If a wife adopted a daughter and the husband made a bequest to the children of the daughter, the children were taxed on the basis of class E instead of class A, which includes direct lineal descendants of the decedent or his spouse and direct lineal descendants of adopted children _of the decedent_. Since the children did not come within either of these categories, they could not be considered class A.[134]

It was not until 1935 that children of adopted children of the decedent were brought within class A. Before that year, they were class E beneficiaries. The 1935 amendment also brought within class A children of step-children, also previously in class E.[135]

Under present law, it has been held that bequests by a deceased son's parents to his surviving wife are taxed on the basis of class A exemption and rates, just as gifts to the wife of a living son would be.[136] However, gifts to the divorced wife of a son have been held taxable on the class E basis.[137] Since class A contains no provision covering the wife of a step-son, she is also taxed as a class E beneficiary.[138] The Attorney General has stated that a gift to a half-sister is taxable on the basis of the exemption and rates of class C, just as gifts to sisters of the whole blood.[139]

Rates Determined by Beneficiary's Relationship to Decedent, and by Amount Received

Except for classes A and B, the Texas inheritance tax rates and exemptions are different for each class. The less close the relationship of the beneficiary to the decedent, the higher the tax rate. The rates are also progressive, increasing as the value of the inheritance increases. For instance, the rates applied to class A beneficiaries (father, mother, husband, wife, children, and grandchildren) range from one to six per cent, depending upon value

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133 Op. Tex. Atty. Gen. No. 0-5457 (August 6, 1943).
134 _Decker_ v. _Williams_, 215 S.W. 2d 679 (Tex. Civ. App., 1948), error ref.
135 Acts 44th Leg., R.S. 1935, ch. 356, p. 922.
136 _Lewis_ v. _O'Hair_, 130 S.W. 2d 379 (Tex. Civ. App., 1939).
137 _Johnson_ v. _Davis_, 198 S.W. 2d 129 (Tex. Civ. App., 1946), error ref.
138 Op. Tex. Atty. Gen. No. 0-5936 (June 27, 1944).
139 Op. Tex. Atty. Gen. No. V-448 (December 3, 1947).

of the inheritance. The same is true for a class B beneficiary (the United States when the gift is to be used in Texas). The rates applied to class C beneficiaries (brother, sister, nephew, or niece) range from 3 to 10 per cent. Rates for class D beneficiaries (uncle, aunt, or cousin) range from 4 to 15 per cent. Class E beneficiaries (all others) from 5 to 20 per cent.[140] This chart shows progressiveness of the rates as applied to various classes of beneficiaries.

CLASSIFICATIONS, EXEMPTIONS, AND RATES OF BENEFICIARIES

Class A. Husband or wife, or any direct lineal descendant of husband or wife, or any direct lineal descendant or ascendant of the decedent, or to legally adopted child or children, or any direct lineal descendant of adopted child or children of decedent, or to the husband of a daughter, or the wife of a son, the tax shall be as follows:

Amount	Rate
$ 0 to $ 25,000	Exempt
25,000 to 50,000	1 per cent
50,000 to 100,000	2 per cent
100,000 to 200,000	3 per cent
200,000 to 500,000	4 per cent
500,000 to 1,000,000	5 per cent
Over one million	6 per cent

Class B. City, town, or county within this state, or to the State of Texas, or to the United States if to be used in Texas.

Amount	Rate
$ 0 to $ 25,000	Exempt
25,000 to 50,000	1 per cent
50,000 to 100,000	2 per cent
100,000 to 200,000	3 per cent
200,000 to 500,000	4 per cent
500,000 to 1,000,000	5 per cent
Over one million	6 per cent

Class C. Brothers, sisters, or their descendants.

Amount	Rate
$ 0 to $ 10,000	Exempt
10,000 to 25,000	3 per cent
25,000 to 50,000	4 per cent
50,000 to 100,000	5 per cent
100,000 to 250,000	6 per cent
250,000 to 500,000	7 per cent
500,000 to 750,000	8 per cent
750,000 to 1,000,000	9 per cent
Over one million	10 per cent

140 Tex. Civ. Stat. (Vernon, 1948) arts. 7118-7122.

Class D. Uncles, aunts, or their descendants.

$ 0 to	$ 1,000	Exempt
1,000 to	10,000	4 per cent
10,000 to	25,000	5 per cent
25,000 to	50,000	6 per cent
50,000 to	100,000	7 per cent
100,000 to	500,000	10 per cent
500,000 to	1,000,000	12 per cent
Over one million		15 per cent

Class E. Charitable, religious, or educational institutions, if money goes out of Texas, or to any other person not included in any of the classes mentioned.

$ 0 to	$ 500	Exempt
500 to	10,000	5 per cent
10,000 to	25,000	6 per cent
25,000 to	50,000	8 per cent
50,000 to	100,000	10 per cent
100,000 to	500,000	12 per cent
500,000 to	1,000,000	15 per cent
Over one million		20 per cent

SOURCE: Comptroller of Public Accounts, Inheritance Tax Division, "Inheritance Tax Laws, State of Texas, 1949," pp. 22-23.

Computing the Tax

This discussion has covered (1) the property and transfers subject to the tax, (2) the permissible exemptions and deductions, (3) the various classes of beneficiaries who are taxed, and (4) the manner in which rates are applied. This information is necessary to compute the amount of the tax. A sample computation follows.

If the net estate after deductions of a resident decedent were worth $200,000, the wife to receive $150,000 and an aunt to receive $50,000, the tax is figured as follows:

Wife's share	$150,000	
Exempt	25,000[141]	
1% on	25,000	$ 250
2% on	50,000	1,000
3% on	50,000	1,500
Total tax		$ 2,750

[141] The rates as applied to the progressive shares are obtained from the foregoing chart. Sample computations are taken from "Inheritance, Estate, and Gift Tax Service, State," pp. 57-223 and 57-224.

Aunt's share	$ 50,000	
Exempt	1,000	
4% on	9,000	$ 360
5% on	15,000	750
6% on	25,000	1,500
Total tax		$2,610

Suppose a resident of Oklahoma (non-resident of Texas) died leaving a net estate of $500,000, of which $200,000 was Texas property, and divided the property as follows: $75,000 to a Texas charitable institution for use within the state, 3/4 of the remainder to his widow, 1/8 to a brother, and 1/8 to a friend. The tax would be computed as follows:

Total estate in Texas		$200,000	
Deductions:			
Debts chargeable to Texas property . .		20,000	
Administration expenses in Texas . . .		5,000	
Bequests to local charity		75,000	
Total deductions in Texas		$100,000	
Net taxable estate in Texas		100,000	
Share of widow (3/4 of $100,000). . . .		75,000	
Exemption		25,000	
Tax on widow's share:			
$25,000 to $50,000	25,000 at 1%	250	
50,000 to 75,000	25,000 at 2%	500	
			$750
Share of brother (1/8 of $100,000). . . .		12,500	
Exemption		10,000	
Tax on brother's share:			
$10,000 to 12,500	2,500 at 3%		75
Share of friend (1.8 of $100,000). . . .		12,500	
Exemption		500	
Tax on friend's share:			
$ 500 to $10,000	9,500 at 5%	475	
10,000 to 12,500	2,500 at 6%	150	$625[142]
Total taxes due Texas.			$1,450

142 Ibid.

It should be noted that heirs to an estate located one-half in Texas and one-half in California will pay less tax than if the estate were entirely within the state. If the same heirs or beneficiaries take property in both states, they may take advantage of the personal exemptions of both and also be subject to lower rate brackets. If they took the entire amount in one state, only one personal exemption would be permitted and the tax rates would be higher under a progressive schedule. In effect, such a system of death taxation seems to penalize a person whose property is located in one state, since his heirs or beneficiaries will pay higher inheritance taxes.

Seven states have sought to remedy this inequity by calculating the tax as if the entire estate were located within it and levying a tax proportionate to the value of the property within its jurisdiction. Under this system, if the decedent in the above example owned an estate of $500,000, $300,000 of which was in Oklahoma and $200,000 in Texas, the tax would have been computed by first determining the amount due if the entire estate ($500,000) had been located in Texas. Since only 2/5 of the estate was in Texas, 2/5 of the tax figure would be the amount of tax due the State of Texas. This would eliminate the inequitable taxation of resident decedents whose property is all in one state. Texas law has no such provision.

Penalties and Refunds

The inheritance tax is due and payable through the Comptroller to the Treasurer 90 days from the date of assessment. The Texas act does not provide a discount if the tax is paid earlier, but if it is not paid within 90 days, the law prescribes a penalty of two per cent per month from the date of assessment.[143] A lien against the property received by the beneficiary covers the amount of the penalty as well as the tax.[144]

Concerning refunds, the statute provides that if debts shall be proved against the estate after the distribution of the property and payment of the tax, a refund of the excess taxes collected shall be made by the executor, administrator, or trustee if he still has the tax, or by the Comptroller upon warrant on the State Treasurer, if the tax has been paid.[145]

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143 Tex. Civ. Stat. (Vernon, 1948) art. 7134.

144 Tex. Civ. Stat. (Vernon, 1948) art. 7133.

145 Tex. Civ. Stat. (Vernon, 1948) art. 7131.

Assessment of the Additional Inheritance Tax

Purpose of the Texas additional inheritance tax[146] is to take full advantage of the 80-per-cent credit for state taxes permitted by the federal government under the Revenue Act of 1926. The additional inheritance tax equals an amount by which 80 per cent of the federal tax (levied under the act of 1926 or "basic act") exceeds the tax levied under the Texas inheritance tax act. Since it is not determined by applying certain rates to the value of the share received by a particular beneficiary, the additional inheritance tax is commonly called an estate type tax.

No Beneficiary Classes, Progressive Rate Schedule, or Deductions

It is not necessary to be concerned with types of property, types of transfers, exemptions, deductions, and rate schedules in dealing with the additional inheritance tax. It is simply an additional tax equal to the difference between the Texas inheritance tax and 80 per cent of the federal tax. For example, if Texas levied a tax of $60,000 against the beneficiaries of an estate, and the federal government under the 1926 act levied an estate tax of $100,000, the tax levied under the Texas additional inheritance tax act would be $20,000, since federal credit would be permitted to the extent of $80,000. It should be noted that credit is permitted only against the federal estate taxes levied under the 1926 or "basic" act and does not extend to additional taxes levied by the federal government since 1926.

If the inheritance tax levied by Texas equals or exceeds the 80 per cent credit, no additional tax is assessed. On the other hand, when no inheritance tax is collected by Texas because of exemptions but a federal estate tax is levied, the Texas additional inheritance tax is levied in an amount sufficient to absorb the 80-per-cent federal credit.[147] Provisions of the Texas additional inheritance tax law are never to be construed so as to increase the total amount of taxes which must be paid to the state and federal governments upon the estate. The purpose of the additional tax is merely to take full advantage of the permitted federal credit.[148]

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[146] Tex. Civ. Stat. (Vernon, 1948) art. 7144a.

[147] Tex. Civ. Stat. (Vernon, 1948) art. 7144a, sec. 4.

[148] Ibid., sec. 8.

Additional Inheritance Tax Apportioned

Since the additional inheritance tax is computed as a lump sum and without any reference to individual beneficiaries, the statute provides that it shall be apportioned among the heirs or beneficiaries of the property in proportion to the inheritance tax assessed against the share of each.[149] If there are two beneficiaries and three-fourths of the inheritance tax is assessed against one heir and one-fourth against the other, the additional inheritance tax will be assessed in the same proportion. Apparently the statute makes no specific provision for apportionment of the additional inheritance tax if no inheritance tax is assessed.

Not only is the federal tax different from the Texas inheritance tax in that the former is an estate tax while the latter is an inheritance-type tax, but also the transfers that are subject to the tax, the exemptions and the rates are not identical. When the additional inheritance tax liability is apportioned, these differences have a monetary impact upon the individual beneficiaries. Where the federal estate tax act taxes a transfer which is not taxed under the Texas inheritance tax, the result of the application of the additional inheritance tax and its apportionment formula could mean that the beneficiaries taxed under the inheritance tax will have to bear the tax upon such a transfer to the beneficiary not so taxed. Stated differently, application of the additional inheritance tax under certain circumstances may mean that some beneficiaries will pay taxes upon property they do not receive while other beneficiaries of the decedent will receive property upon which they pay no state death taxes.

Computing the Additional Inheritance Tax

The computation of the tax has been described briefly above.

The additional inheritance tax statute provides for computation of the tax in two other situations--(1) where the decedent was a non-resident and owned property located in Texas and (2) where the decedent was a resident but owned property located outside Texas. The method of computing the additional inheritance tax is the same in both instances. In either situation, the tax is to be computed according to the ratio which the net estate located in Texas bears to the total net estate.[150] For instance, suppos the decedent were a non-resident of Texas and that three-fourths of his estate were located in Texas. If the federal estate tax under the 1926 Act amounted to $100,000 and Texas collected an inheritance tax of $40,000 under chapter 5,

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[149] Ibid., sec. 2.

[150] Ibid., secs. 14 and 15.

the additional Texas inheritance tax would be computed by first finding the federal credit--$80,000--and then determining how much of it is to be apportioned to Texas. Hence the tax would be $60,000, or three-fourths of $80,000. Since the difference between the tax levied under the inheritance tax and the amount of the federal credit apportioned to the State of Texas is $20,000, this is the amount levied under the additional inheritance tax.

Penalties and Refunds

The additional inheritance tax is due 30 days after the notice of assessment. No discount is allowed for early payment of the tax. However, if the tax is not paid within three months, a penalty of two per cent per month is effective from the date the taxes became due. The additional inheritance tax bears six per cent per annum interest from the date of notice until paid. However, if the tax is not paid within three months and the penalty is assessed, the penalty is in lieu of the interest. If the estate is divided among several beneficiaries, it is possible for one to pay the tax on his share and relieve his property from the interest and penalty.[151]

The statute provides that if an overpayment of the taxes has been made, the Comptroller shall refund the overpayment from any subsequent inheritance tax collections.[152]

Legal Interpretations Important

Legal interpretations of the inheritance and additional inheritance taxes play an important role in their administration. Interpretations originate from three sources--the Comptroller's Office, the courts, and the Attorney General's Department. Most of the interpretations are made by the Attorney General. His opinions serve as guides for the Comptroller in administering the taxes. The Inheritance Tax Division has 142 opinions on file, and there is indication that the courts are willing to accord considerable weight to the opinions. In Crane v. Mann, the court said the Attorney General's "construction having been acquiesced in by the Legislature for more than twelve years is of itself persuasive and should not be overturned in the absence of strong reason therefor."[153] Court decisions have not been nearly so numerous as Attorney General's opinions, however. Between 1934 and 1945, 11 cases reached the Supreme Court of Texas.[154]

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[151] Ibid., sec. 6.

[152] Ibid., sec. 12.

[153] Crane v. Mann, 162 S. W. 2d 117, 118 (Tex. Civ. App., 1942) error ref.

[154] Letter from Cecil Bird, director, Inheritance Tax Division, to C. H. Cavness, dated August 11, 1945, a copy of which is on file with the Legislative Council.

Skipping Inheritance Taxes

By making a devise of a life estate to one generation and a remainder to a succeeding generation it is possible for property to change hands and skip an inheritance tax. For instance, when a devise of a life estate and remainder is made, the life estate is valued under the Texas act by reference to the "Actuaries Combined Experience Tables" at four per cent compound interest.[155] After the value of the life estate has been determined, the difference between the actual value (at death) and the value of the life estate is the value of the remainder. Since the transfer of the life estate and the remainder is considered one transfer and each is taxed only on a proportionate part of the value, the full value of the property is taxed only once, although the possession of the property has changed twice.[156]

Future Interests

A property owner often wishes to assert a measure of control over the use of property after his death. This may be accomplished in a number of ways, including specifying in the instrument creating the gift that the property is to be placed in trust, with the income to go to a certain person for life, and the remainder is to go to another person or persons.

The Texas act refers to the taxability of property which has been divided into two or more estates, such as a life estate or estate for a certain number of years, followed by a remainder. It specifies that the tax shall be levied against each estate separately, according to the value at the time of decedent's death as determined from the "Actuaries Combined Experience Tables" at four-per-cent compound interest.[157]

If the life tenant is given the power to invade or use up the property transferred and not merely to receive the income therefrom, Texas regards him as owning all interest in the property. The state accordingly assesses the entire tax against the life tenant. Actually, this seems to be done even when the life tenant does not have the power to invade or use up the gift, since taxes on the life estate and on the remainder interest are both payable out of the principal body of the estate. This reduces the share of the life tenant, and he does not receive as much as he pays tax on.

Several states permit the person who is to receive the remainder of the estate to give bond to pay tax on the remainder when the life estate expires.[158] The life estate and the remainder are two separate estates, and this arrangement allows each recipient to meet his own tax without diminishing the value of the other's interest and permits the remainderman

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155 Tex. Civ. Stat. (Vernon, 1948) art. 7123.

156 Groves, op. cit., p. 245.

157 Tex. Civ. Stat. (Vernon, 1948) art. 7123.

158 "Inheritance, Estate, and Gift Tax Service, State," op. cit., p. 80-394, para. 2105B.

to make the tax payment at the time that he receives possession of the property. Although the remainder interest has value, it is not easily sold for an adequate price; hence this arrangement allows the remainderman to pay his taxes when he receives the more valuable interest in property, that is full title.

The discussion thus far has considered vested remainders, which is an interest in property which cannot be defeated by any contingency. The contingent remainder is different from the vested remainder; it may never mature into the right to possess and use the property. The situation may be clarified by a simple illustration. Father in his will left the ranch to his daughter for life with the remainder to her children; if she dies childless, however, the remainder shall go to an uncle. The uncle's interest in the ranch is called a contingent remainder. In order for the uncle ever to get the right to take possession of the ranch, the daughter must die childless.

Contingent remainders have been a source of difficulty in the administration of inheritance taxes. Obviously, it is not certain that the contingency--daughter dying childless--will ever occur. Although a contingent remainder is an interest in land and so may be sold, it is difficult to value because of the uncertainty of the interest ever maturing into really useful interest in the property. However, by applying actuarial data and methods a value can be placed upon the contingent interest. Texas computes the value of the various interests at the time of the death of the decedent. Thus, in the example given, a value would be assigned to the daughter's life estate, to the remainder of the children, and to the uncle's contingent remainder and the applicable rates applied to the various gifts. Determination of the tax due is not postponed until the events occur which determine the final disposition of the property.[159]

Several difficulties in this apparently logical approach are evident. In determining the tax due on the remainder to the children, an estimate must be made of the number of children the daughter will have so that the number of exemptions can be assigned. If, for example, at her father's death the daughter is a young unmarried woman, it can be seen that this determination is hazardous. If the uncle pays the tax levied upon the gift to him, he may pay a tax upon a property interest which may disappear. The uncle might view the probabilities of his ever receiving the right to take possession so remot that he will not pay the death tax assessed against him. It can also be seen that the tax collected upon the basis of the facts existing at the decedent's death could very easily be either more or less than that which would be collected if the facts of the eventual disposition of the property were used.

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[159] See Bethea v. Sheppard, 143 S.W. 2d 997, 1003 (Tex. Civ. App., 1940) error ref'd. The court rule that the tax on a contingent interest is payable immediately after the death of a grantor and that nothing in the statute authorized postponement of the tax.

Apparently for the purpose of treating both the beneficiary-taxpayer and the state more fairly, some states have devised schemes which provide fairly satisfactory solutions to this vexing problem. The first method is to wait until the person or persons who will take the interest can be determined before assessing the tax.

The second is to assess the tax at the highest applicable rate under terms of the bequest and refund excess taxes paid if the interest does not pass to the person or persons to whom the tax rate was applicable. The third solution is the reverse of the second. The state may assess the lowest applicable rates at the decedent's death and require additional taxes if the inderest does not pass to the person or persons to whom the tax rate was applicable. In this instance, payment of the tax may be secured by requiring a bond or deposit.[160]

Texas assesses the tax on the basis of the facts existing at the decedent's death and the tax is then payable. There is no provision for either refunding taxes collected or collecting additional taxes when the actual disposition of the property takes place. However, the tax is not administered in accordance to the strict letter of technical property law. The tax administrator makes a judgment concerning the nature of the contingent interest; if it is considered too remote, it is ignored for tax purposes. For example, if in the illustration given above the daughter had children living at the decedent's death, the contingent remainder to the uncle would not be taxed as a gift to him but would be included in the valuation of the gift to the children. Thus, the children would be taxed for the uncle's interest as well as their own. This means that the gift to the uncle would be taxed according to the lower class of rates applicable to children; however, as the inclusion of the gift to the uncle in computing to tax on the gift to the children may bring the total of the gift to them into a higher tax bracket, the tax rate may occasionally be about the same as it would have been had the rates applicable to an uncle been used. Apparently, the remoteness test is occasionally used on vested interests as well as contingent interests.

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[160] "Inheritance, Estate, and Gift Tax Service, State," op. cit., p. 80-315, para. 1845B.

SECTION 4 - COLLECTION AND ENFORCEMENT

General

The primary responsibility for collection and enforcement of the Texas inheritance and additional inheritance taxes has been given to the Comptroller, who has delegated the responsibility to the Inheritance Tax Division. Although the same administrative personnel administers both taxes and although assessment of the additional inheritance tax is dependent upon the inheritance tax, the taxes can be better understood by discussing separately the collection and enforcement of each. This discussion seeks to present as nearly as possible in chronological sequence the procedure of collection and enforcement.

The Inheritance Tax
Coverage Control -- Reports

A very important problem to be solved in formulating an inheritance tax statute is that of providing some means whereby the administrator will be notified of the taxable event. In other words, an inheritance statute must provide for notifying the tax administrator of the death of an individual so that the tax can be assessed against the recipients of his estate. The Texas inheritance tax act and that levying the additional inheritance tax seem to have provided ample solutions to this problem by requiring that a number of individuals submit reports.

Reports of the existence of a taxable estate may reach the Inheritance Tax Division from three sources--(1) the bank where the decedent kept deposits, (2) the county clerk of the county where the estate is administered, and (3) the executor, administrator, or heirs.

The additional inheritance tax law passed in 1933 requires banks and safe deposit companies to notify the Comptroller at least ten days before delivery of the deposit to the heirs or legal representatives of the estate.[161] The delivery may be made only in the presence of the Comptroller or his authorized representative. To facilitate compliance with these provisions, the Comptroller has commissioned an employee of each bank in the state as his agent to take inventory of the deposits and report to him. Banks and safe deposit companies are a valuable source of information for the Inheritance Tax Division.

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[161] Tex. Civ. Stat. (Vernon, 1948) art. 7144a, sec. 16.

County clerks are required to report to the Comptroller within 20 days after the representatives of the estate have filed and secured approval of the inventory, appraisement, and list of claims,[162] giving names of the decedent, the executor or administrator, the beneficiaries, and the value of the shares received by each beneficiary. The county clerk receives this information from the executor or administrator, who is required to report to the county clerk within ten days after the inventory, appraisement, and list of claims have been filed and approved by the probate court.[163]

Every executor, administrator, or other person coming into possession of a portion of an estate is required, within one month after coming into possession, to file what is termed a "preliminary report" with the Comptroller. This includes the date of the decedent's death, approximate value of the estate, and the names of the persons entitled to receive it.[164]

Another possible source of information concerning taxable estates is found in federal estate tax returns. By a provision of the additional inheritance tax act, the Comptroller has authority to confer with the United States Department of Internal Revenue and ascertain the value of Texas estates upon which the federal tax has been assessed.[165]

With the system of reports required by the inheritance and additional inheritance tax statutes, it seems probable that an insignificant number of estates fail to reach the attention of the Inheritance Tax Division.

Penalties for Failure to File Required Reports

Each of the provisions requiring reports is further supported by penalty provisions of from $50 to $250[166] (if the county clerk fails to file the required report), from $100 to $1,000[167] (if the administrator or executor fails), and from $1,000 to $5,000 (if a bank or safe deposit company fails to make the required report).[168] There is no record of the penalty provisions having been applied.

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162 Required under laws pertaining to administration of estates of decedents. See Tex. Civ. Stat. (Vernon, 1948) arts. 3408-3412.

163 Tex. Pen. Code (Vernon, 1948) art. 107a.

164 Tex. Civ. Stat. (Vernon, 1948) art. 7126.

165 Ibid., art. 7144a, sec. 13.

166 Tex. Pen. Code (Vernon, 1948) art. 107a.

167 Ibid., art. 140.

168 Tex. Civ. Stat. (Vernon, 1948) art. 7144a, sec. 16.

The executors and administrators are further prompted to file inheritance tax reports and pay the tax by a provision which requires that the county judge refuse to allow their final account until they show, by an instrument in writing signed by the Comptroller, that inheritance taxes have been paid.[169]

Lien for Inheritance Tax

The report of the executor, administrator, or heir is further prompted by the fact that the state is given a lien for the amount of the inheritance tax, including penalties and costs incurred in enforcing the lien.[170] Even if the Comptroller did not receive notice of the existence of the estate and it were permitted to evade the tax, the lien for the tax due remains. Consequently, should the heir or beneficiary desire to sell land or certain shares of stock received from the estate, he might encounter difficulty since his title would not be clear because of the lien.

Preliminary Report Reviewed by the Inheritance Tax Division

As soon as the preliminary report is received from the administrator, executor, or heir, the Inheritance Tax Division sets up a file for the particular estate. These inheritance tax files are permanent records. If the division learns of the existence of the estate through another source, the heirs or representatives of the estate are requested to file the preliminary report. If the report indicates beyond a doubt that the estate is not taxable, a certificate of no tax due is issued. This must be signed by the county judge and approved by the Comptroller. However, if there is a possibility that the estate will be taxable, the division waits until after the "final report" is filed and a further check conducted.

Final Report Required Within Six Months

Within six months after the heirs or representatives of the estate come into possession, they are required to file a "final report"[171] which is, in effect, the inheritance tax return. The report is submitted on a

169 Ibid., art. 7135.

170 Ibid., art. 7133.

171 Ibid., art. 7127.

special form entitled "Affidavit for Inheritance Tax Appraisement." It includes an itemized statement of the value of the estate, which must be accompanied by a copy of the decedent's will if he died testate. The form is prepared to require a separate appraisal for the various types of property, including (1) real estate; (2) stocks, bonds, mortgages, accounts receivable, interest in co-partnership, and cash deposits; (3) livestock; (4) chattels; (5) insurance; (6) property transferred in contemplation of death and transfers during the decedent's lifetime in which he retained any beneficial interest; and (7) property disposed of by the exercise of a general power of appointment. The Texas inheritance tax act taxes only transfers made under exercise of a general power of appointment by will. However, the form requires that all property disposed of during the decedent's lifetime by exercise of a general power of appointment be reported. The law provides a penalty for failure to file the requested report[172] as well as for knowingly filing a false report.[173]

If the value of the estate has been determined for the federal estate tax and that tax has been assessed, the heirs or representatives are required to submit such information at the time the final report is submitted.[174] If the information is not available when the final report is filed, it is required within 30 days after the value of the estate for federal tax purposes has been determined. As a practical matter, it usually takes much longer to close out an estate under the federal tax than for the state to assess its inheritance tax. This report of the federal tax serves as the basis for assessment of the Texas additional inheritance tax. The law also provides that the federal valuation may be used by the Comptroller in revaluing the estate for the inheritance tax after giving notice and granting a hearing to interested parties.[175]

When the final report is received by the Inheritance Tax Division, it is audited by a staff of examiners who make an office check for apparent errors in valuation, check terms of the will against actual distribution, and determine whether the tax has been computed correctly. Experience has created the policy of checking rather closely estates valued under $500,000, since the greatest amount of inheritance tax revenue is received from estates of this kind. However, if the value is above $500,000, the greatest revenue is usually obtained from the additional inheritance tax, and a close check of such an estate is unnecessary.

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[172] Tex. Pen. Code (Vernon, 1948) art. 140.

[173] Tex. Civ. Stat. (Vernon, 1948) art. 7139.

[174] Ibid., art. 7144a, sec. 10.

[175] Ibid., sec. 11.

Field Investigation

After the report has been processed by office examiners, it is turned over to one of seven field examiners, depending upon where the estate was administered, who is more familiar with property values in the particular area, and who can conveniently make an actual check of the property. All taxable estates are subject to field investigation. Should the field examiner determine that the report correctly reflects the value of the estate and contains a correct computation of the tax, an order assessing the tax is prepared. The order, which must be signed by the county judge, is sent to the administrator, executor, or heir. Upon payment of the tax, the Inheritance Tax Division issues a receipt.

Should the field examiner determine that the information given in the final report does not represent the true value of the property, he consults the attorney for the estate and seeks to reach an agreement as to a revaluation. If an agreement is reached, an order assessing the tax is issued. If no agreement is reached, the statute provides that the county judge appoint two appraisers approved by the Comptroller to determine the value of the property.[176] The law also provides that should there be dissatisfaction with the appraisal, appeal may be had to the county or district court, providing a motion for appeal is filed within ten days after the appraisers file their report. If the appraisal is appealed, assessment of the tax is delayed pending the appeal.[177]

If the parties interested in the estate agree to dispense with appointment of appraisers, the appraisal may be made by the Comptroller and the county judge.[178] It is under this provision that the field examiner bargains with the estate's attorney to reach an agreeable valuation.

Bases for Appraisal

The statute requires that the property be appraised at its actual market value--if it has a market value--at the time of the decedent's death. If it does not have market value, it is appraised at its real value at the decedent's death.[179]

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[176] Ibid., art. 7130.

[177] Ibid., art. 7131b.

[178] Ibid.

[179] Ibid., art. 7130.

The distinction between actual market value and real value is of particular importance in the case of closely held stocks which have no market value and must, therefore, be appraised at their real value.

The Comptroller's pamphlet discusses how various types of property are appraised.[180]

City real estate is appraised by considering the value of the land separately from the improvements, which are valued on the basis of replacement costs less depreciation.

Acreage is assessed by considering the value of the surface separately from the value of the oil or other minerals "that the same may contain, either actual or potential."[181] In determining value of the minerals, the Inheritance Tax Division will accept the appraisal of any recognized petroleum engineer. If there have been no sales of the land, the division will accept appraisals of the Federal Land Bank Appraisers, Expert Appraisers, or a group of qualified and disinterested persons.

Stocks and bonds listed on an exchange are valued at selling price at the close of the market on the date of the decedent's death. When stocks are not listed on an exchange but are traded in actively, the division will accept letters from brokers tending to show actual value. If the stock is closely held, it is common to accept book value. Secured notes are appraised at face value. Unsecured notes are valued by taking into consideration the ability of the maker to pay. If the decedent cancels a note in his will, the value of the bequest is the face value of the note.

The value of a co-partnership interest is determined by the value of the decedent's interest and not on the basis of physical assets of the partnership. For this reason, the Comptroller requires that a financial statement and a balance sheet accompany the final report. The value of life estates and estates for years is computed by the "Actuaries Combined Experience Table" at four-per-cent compound interest.[182]

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180 "Inheritance Tax Laws, State of Texas, 1949" op. cit., p. 25.

181 Ibid.

182 Tex. Civ. Stat. (Vernon, 1948) art. 7123.

Payment of the Tax - Penalties for Late Payment

The inheritance tax statute provides that the tax is payable to the Treasurer of the State of Texas through the Comptroller.[183] Before an amendment in 1945, the tax was payable to county tax collectors.

The tax is due and payable to the Comptroller within 90 days from the date of assessment. If it is not paid on or before the due date, a penalty of two per cent per month from the date of assessment is charged.[184]

Should persons interested in the estate be dissatisfied with the manner in which the tax was computed, in which deductions were allowed, or in which rates were applied, they may pay the tax under protest and bring suit for recovery of the alleged overassessment.[185] This is the procedure commonly used to contest the inheritance tax officer's interpretation of the law. The Inheritance Tax Division does not defend the suit. This function is handled by the Attorney General, whose concurrence in all interpretations is essential before the inheritance tax officer can take any action.

Foreclosure of the Lien - Suit for Delinquent Taxes

After the tax has been finally assessed, there are two methods by which its payment may be enforced -- (1) by foreclosure of the lien or (2) by suit for delinquent taxes. If inheritance taxes are not paid within nine months from date of assessment, the Comptroller notifies the county attorney, and it is his duty to foreclose the tax lien securing payment of the taxes.[186] The statute provides that the lien may be enforced against any person acquiring an interest in the property. There is no record of foreclosure of a lien for inheritance taxes, apparently because such measures have never had to be taken to collect the tax.

If the tax is not enforced by foreclosure of the lien, suit may be brought by the State Tax Board for delinquent inheritance taxes under article 7076.[187] Such a suit must be brought in Travis County.

183 Ibid., art. 7132.
184 Ibid., art. 7134.
185 Ibid., art. 7057.
186 Ibid., art. 7134.
187 Ibid., art. 7076. See Scanlan v. State, 215 S. W. 2d, 203 (Tex. Civ. App., 1948).

Collection and Enforcement of the Additional Inheritance Tax

The additional inheritance tax act requires that the "methods and means of collection and enforcement, by suit or otherwise, shall be governed by the provisions of the inheritance tax laws of this state." [188] Hence the Comptroller is also vested with the primary responsibility of enforcing this tax.

The additional inheritance tax cannot be assessed until the amount of the federal estate tax has been determined, since the additional tax is computed by taking the difference between 80 per cent of the federal taxes levied under the 1926 act and the amount levied under the Texas inheritance tax act. [189]

Report of Federal Valuation

A report of the federal assessment and valuation, under oath, is required at the time the "Affidavit for Inheritance Tax Appraisement" (final report) is submitted if the information is available at that time. Otherwise, it is required within 30 days after the value of the estate for federal tax purposes has been fixed and the tax assessed. [190] Failure to file the report invokes a penalty of from $25 to $250. [191] To verify the submitted report and also to determine whether some estates have failed to submit required reports, the statute authorizes the Comptroller to confer with the Department of Internal Revenue to ascertain the value of estates assessed for the federal tax. [192]

Once the federal estate taxes payable are ascertained, it is a simple matter to determine if additional taxes are due. Should an additional tax be required for Texas to take full advantage of the federal credit, the Comptroller so notifies the legal representatives of the estate and every person who owns a taxable interest in it. [193]

Payment of the Tax - Penalties for Late Payment to the Comptroller

The taxes become due and payable to the Comptroller within three months from the date of notice and bear interest at the rate of six per cent per annum from the date of notice. [194] If the taxes are not paid within the specified time, penalty interest is charged at two per cent per month from the end

188 Tex. Civ. Stat. (Vernon, 1948) art. 7144a, sec. 7.

189 For an interesting case involving the computation of additional inheritance tax due when federal estate taxes are compromised, see State v. Wiess, 141 Tex. 303, 171 (S.W.) 2d 848.

190 Tex. Civ. Stat. (Vernon, 1948) art. 7144a, sec. 10.

191 Ibid., sec. 13.

192 Ibid.

193 Ibid., sec. 11.

194 Ibid., sec. 6.

of the three-month period until the tax is paid. If a penalty is charged, it is in lieu of interest. The recipient of any share of the estate may pay his pro rata share of the additional taxes assessed and relieve his property from the interest and penalty. The penalty provision under the additional inheritance tax law is a modification of that under the inheritance tax.

Liens

The statute also gives the state a lien for the payment of the additional inheritance tax. [195] The lien is enforceable against the entire estate, but if two or more persons become owners of taxable interests and if inheritance taxes are assessed against them, the additional tax is in proportion to the amount of the inheritance tax assessed against each share.

Should the taxes be unpaid at the end of nine months, the county attorney is required to file suit to foreclose the lien. [196]

Disposition of Revenues

The statutes require that the revenue from both the inheritance tax and the additional tax be deposited in the State Treasury to the credit of the General Revenue Fund. [197] The inheritance tax is one of three taxes from which all revenues go into this fund. [198]

Compensation of Tax Administrators

The inheritance tax statute specifies the compensation which the county judge, the county attorney, and appraisers are to receive for their services. [199] The county judge is allowed a fee not to exceed $30 in any one estate. This is in addition to the taxes levied and collected and is collected as part of the costs in probate cases.

If the county or district attorney brings suit, he receives five per cent of the amount of taxes payable, not to exceed $200 in any one case.

195 Ibid., sec. 2.
196 Ibid., sec. 11.
197 Ibid., art. 7143 and art. 7144a, sec. 12.
198 E. T. Miller, "The Historical Development of the Texas State Tax System," Southwestern Historical Quarterly, LV (July, 1951), p. 1.
199 Tex. Civ. Stat. (Vernon, 1948) arts. 7141 and 7130.

The fee is collected from the estate in addition to taxes and penalties. The aggregate of fees received by the county judge and county attorney in such cases must not exceed $2,000 in any year. Fees earned in addition to that sum are considered a portion of the taxes and penalties and distributed in the same manner.

Appraisers are entitled to five dollars for each day they work in appraising the property, together with actual necessary expenses incurred therein.

Conclusion

This discussion demonstrates that enforcement of the inheritance tax requires co-ordinated efforts of the Comptroller and a number of other persons or agencies. The concurrence of the Attorney General in the interpretations of the Inheritance Tax Officer is essential if protest payments are to be sustained. The county attorney must agree to foreclose the lien, despite the mandatory language of the statute. And the State Tax Board must agree to file suit for delinquent taxes. This decentralization, which requires the Comptroller to seek outside help to enforce the tax payments, seems to decrease efficiency of the administration of the inheritance tax law.

Another difficulty is presented by the limited number of field examiners available to the Inheritance Tax Division. The present inflationary period has brought many estates within the taxable bracket and consequently has imposed a strain on the seven examiners, who must cover the entire state.

SECTION 5 - ANALYSIS OF OPERATION

Administrative Costs

The states are generally able to collect their death taxes with an expenditure for administration that represents only a slight percentage of total collections.[200] Measured as a percentage of receipts, the cost of administering the Texas inheritance and additional inheritance tax seems to be fairly low; the inheritance tax officers estimate that collection costs are about one per cent of receipts. Separate cost data for the inheritance tax and the additional inheritance tax are not obtainable.

One explanation for the low collection costs for this tax is that a number of persons other than employees of the tax administrator perform important functions in facilitating collection of the tax. The Comptroller's Office is assisted by the Attorney General, the State Tax Board, the county judges, county attorneys, county clerks, appraisers, and the representatives of the estates. These persons play a role in the administration of the tax incidental to their principal duties. Apparently, costs of services performed by these persons are not considered in stating the administrative costs for this tax.

Texas seems to have an intermediate position among the states as to salaries for employees who administer the tax. The annual salary appropriation for the 14 employees of the Inheritance Tax Division for the biennium 1949-1951 was $54,360.[201] The appropriations act for the current biennium does not set out the appropriation for each division in the Comptroller's Office but prescribes a salary schedule according to the duties performed in the Comptroller's Office.[202] Applying the terms of the 1951 act to the 14 employees of the Inheritance Tax Division would place their total annual salaries at slightly above $60,000.

Texas Collections Compared with Those of Other States

For the fiscal year 1949, the states collected death taxes totaling $175,621,443, compared with $796,538,000 for the federal government. Of the state total, more than 47 per cent was collected by four states -- New York, Pennsylvania, California, and Massachusetts. New York levies an estate-type tax; the other three have inheritance taxes. California levies a supplementary gift tax.

Texas collections for 1949 amounted to $6,047,111, or about 3.4 per cent of the total for the states -- considerably above the average for the 44 states below the four highest.

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200 Heller and Harriss, Administration of State Death Taxes, 26 Iowa L. Rev. 646 (1941).

201 Acts 51st Leg., R.S. 1949, ch. 615, p. 1226.

202 Acts 52d Leg., R.S. 1951, ch. 499, pp. 1322-1323.

In 1950, the same four states collected more than 45 per cent of the total state death taxes. Texas collected $5, 232, 515, or about 3.1 per cent of the total.[203]

In amount of inheritance taxes collected, Texas ranked 10th in 1948, 8th in 1949, and 10th in 1950. This seems to indicate that although Texas' collections in 1950 were less than one-fourth those of New York, which collected most, it still ranks considerably above average.

A breakdown of inheritance tax collections for 1950 shows this picture:

18 states collected less than 1 million dollars.
19 states collected from one to four million dollars.
7 states collected from four to ten million dollars.
1 state collected from 15 to 20 million dollars.
2 states collected from 20 to 22 million dollars.[204]

Analysis of Receipts

Revenue receipts from the taxable estates totaled $5, 196, 815 in 1951. Of this amount, $3, 886, 608 was derived from inheritance taxes and $1, 310, 206 from additional inheritance taxes.[205] The ratio of taxes collected under the two taxes fluctuates widely, as these figures show:

Fiscal Year Ending	Inheritance Tax Collections	Additional Inheritance Tax Collections
1950	$3, 686, 569	$1, 427, 530
1949	2, 606, 563	3, 337, 900
1948	3, 298, 424	825, 535
1947	1, 768, 144	653, 234[206]

The fluctuations, particularly in additional inheritance tax receipts, are probably the result taxing several large estates in one year.

An amendment to the federal law in 1948 may also help explain the decline in revenue from the additional inheritance tax in 1950 and 1951. Before 1942, under the federal act, a decedent's estate in a community property state had an advantage over those in other states. When through the labors of the husband property is accumulated during the marriage, the community property state regards only one-half of it as belonging to the husband. However, in a non-community property state, if, as customarily happens, title to the property is taken in the husband's name, the entire accumulation is regarded as that of the husband. This meant that generally only one-half of the property acquired by the

203 Commerce Clearing House, "Tax Systems"(supplement to 12th edition), January 1, 1951.
204 Ibid., "Tax Systems," op. cit.
205 Records of the Inheritance Tax Division, Comptroller's Office.
206 Ibid.

marriage partnership was subject to the federal estate tax in community property states and all of it was taxed in the other states.

Assuming that this situation resulted in inequality of treatment, Congress provided in 1942 that upon the death of either spouse, all community property was subject to the federal estate tax (with certain exceptions). Because of opposition to taxing community property, Congress amended the law in 1948. In general, the law was changed so as to treat decedents in community property states as they were treated before 1942 and to extend the community property tax advantages through the marital deduction to those living in non-community property states.[207]

Operation of the Inheritance Tax Division

The Inheritance Tax Division processed and closed out a total of 6,153 estates in the year ended August 31, 1951. Of this number, no tax was due on 4,070, leaving 2,083 taxable estates. The division usually has a backlog of 1,600 to 1,700 estates which have not been closed out.

Most of the estates are closed out within two years after the decedent's death if the executor or administrator files reports promptly. However, cases for some estates have been pending for as long as five or six years. Will contests explain some of these delays; others may result from contested tax cases. The usual number of cases in litigation is about seven or eight.

The Work of the Field Examiner

The field examiner has one of the most important duties in the administration of the inheritance tax. His work, it appears, is almost as important as that of determining the existence of the taxable estate. The determinative appraisal of the estate is largely his task. The statute provides that appraisers be appointed by the county judge and approved by the Comptroller, or that appraisal be made by the county judge and the Comptroller if the interested parties waive third-party appraisal. The latter provision is the basis for appraisal by the field examiner.

When all the reports have been received by the Inheritance Tax Division Office, they are turned over to the field examiner, who usually contacts the estate's attorney. If the field examiner feels that valuations in the final report or return are too low, he seeks to arrive at a correct valuation by bargaining with the attorney. This negotiation provides a speedy and fairly satisfactory method of appraising the property. In the 1950-1951 fiscal year, revaluations by the examiners accounted for about $639,000 in additional tax collections.

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207 Commerce Clearing House, "Federal Tax Guide, 1951," par. 4518.

Despite the significant increase in revenue brought about by these revaluations, the field force seems inadequate to care for the heavy work load. As has been mentioned, some 2,083 taxable estates were closed out in the fiscal year ending in 1951. Since it is the policy of the Inheritance Tax Division to make a field check of all taxable estates, each of the seven field men checked and closed out an average of almost 300 estates during the year, an average of more than one estate per working day. It seems doubtful that maximum efficiency is achieved by placing such a heavy case load on seven men. The material previously set out in this chapter indicates that the field examiner's job may not be an easy mechanical task.

The appraisal practice employed in the administration of the Texas death tax is probably as good as or better than that envisioned by the statute as the usual method -- appointment by the county judge of laymen to make the valuation. Nation-wide experience seems to indicate that laymen appointed for the purpose are often little more than rubber stamps for the representative or attorney for the estate.[208]

Importance of Texas Inheritance Taxes

It has been pointed out that inheritance taxes and additional inheritance taxes are increasing in importance as revenue-producers.[209] For the fiscal year ending in 1950, \$.0093 of every dollar received by the state was derived from inheritance taxes. In 1949, the figure was \$.0116 and in 1948, \$.0079.[210]

Factors Influencing Revenue Receipts

Obviously, the revenue yield of the death tax in the several states is dependent upon a number of factors, including the number of moderate and large-sized estates, the rate schedule, the exemptions, and the deductions. For that reason, generalizations concerning relative effectiveness of inheritance taxes of various states as revenue-raisers, based upon consideration of a particular factor, will be somewhat misleading. The fact that Texas revenue from the inheritance tax is only about one-fourth that of New York does not necessarily mean that the New York law is a relatively more effective revenue-producer. However, a consideration of some of the factors that influence the tax yield may be instructive.

Comparing Texas rates with those of two states who lead in collections from this tax shows that the Texas rates range from 1 to 20 per cent, California rates from 2 to 16 per cent, and Massachusetts rates from 1 to 15 per cent. However, the width of the brackets in the rate graduations have an important place in any such comparison. The Texas graduation appears to be lower than those of California and Wisconsin.

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208 Heller and Harriss, *op. cit.*

209 Miller, op. cit.

210 Annual *Reports* of the Comptroller of Public Accounts, 1948, 1949, and 1950.

Exemptions granted on the basis of the relationship of the beneficiary to the decedent will also have an important impact upon the revenue yield of an inheritance tax. Of the 37 states which levy inheritance taxes, only three grant an exemption in excess of the $25,000 one which Texas permits direct heirs; Michigan permits a $30,000 one in such cases, Iowa a $40,000 exemption, and Kansas a $75,000 exemption.[211] It is common to grant the highest exemption only to the surviving spouse, granting children a considerably lower one. For example, California divides its Class A beneficiaries into three groups and permits different exemptions -- $24,000 for the wife, $12,000 for a minor child, and $5,000 for others. Sixteen of the 37 states imposing inheritance taxes have a maximum exemption of $10,000; 8 states have smaller maximum exemptions; and three allow no exemptions.

Although state utilization of the 80-per-cent federal credit tends to erase any difference in yield of state taxes resulting from difference in coverage of transfers taxed, at least with regard to estates subject to substantial federal estate tax, it would seem that some of the difference in death tax receipts by the states can be explained by such differences in coverage. Of the four states which collected almost one-half the death taxes in 1950, interestingly, only California supplemented its death tax with a gift tax. This indicates that death taxes can be made to yield substantial revenue without also imposing a tax on gifts made during lifetime and which are not testamentary in character.

Of course, lower revenues can result from administrative deficiencies. Failure to locate taxable estates and under-valuation of an estate's property can both have important effects upon the revenue yield of a death tax. It is extremely doubtful that any significant number of sizable estates escape the attention of Texas administrative officials.

The economic level in a state will have a significant effect upon the revenue results of the imposition of a death tax. Also, in view of the exemption schedule and the graduated rate structure, the relative concentration or dispersion of wealth in a state will have an impact upon the yield of this tax. It is apparent that the number of wealthy persons who live in New York and California help account for the large revenue yields in those states.

This discussion is included to indicate to persons interested in increasing or decreasing the revenue yield of the inheritance tax that there are a number of factors to be considered. The yield may be changed, obviously, by making a change in rates. But important changes in revenue may also be brought about, among other ways, by changing the rate brackets, by changing the exemptions, and by changing transfers subject to the tax.

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211 Report of California Legislature, op. cit.

SECTION 6 - SUMMARY AND PROBLEM AREAS

Death taxes are apparently firmly established revenue devices for the states and the federal government. All except Nevada impose such a tax. Ten states and the federal government impose an estate type tax and 37 impose an inheritance-type tax. Thirty-two of these 37 follow the Texas pattern of a basic inheritance tax supplemented by an additional tax designed to absorb the full 80 per cent federal credit; the remaining five have designed their rate structures so as tax at an amount which approximates the amount of the federal credit. Twelve states and the federal government supplement their death tax impositions with a tax on gifts made by the decedent during his lifetime and which gifts are not sufficiently testamentary in character to be subject to the death tax.

A thoroughgoing re-examination of the Texas death tax would probably include a consideration of the following areas of inquiry: Should Texas retain the inheritance-type tax or shift to the estate-type tax? Should Texas subject all gratuitous dispositions of property to a tax; that is, should Texas supplement its inheritance tax with a gift tax? What transfers are not subject to the Texas inheritance tax that should be included in the law's coverage? Is the present schedule of exemptions reasonable? Are there any provisions that result in unreasonable discriminations among taxpayers? In what ways can the tax administration be implemented so as to make it more adequate to the task?

Type of Death Tax

The inheritance and estate tax are the two basic types of death taxes. The inheritance tax is conceived as a tax upon the privilege of receiving a gratuity from the deceased, and the estate tax is considered a tax upon the privilege exercised by the deceased of giving his property away at his death. In its pure form, the inheritance tax is imposed upon the beneficiary and is to be paid by him out of his gift, whereas the estate tax is imposed upon the total estate of the decedent and is to be paid out of the residuary.

Any consideration of the two types of taxes will reveal that each has certain merits and limitations.[212] The federal credit provision means that there is a degree of integration of the death tax program of the federal government and that of a state. The fact that the federal tax is an estate tax might argue that a better cohesion of the two tax programs would result if the state also imposed an estate tax.

From viewpoint of ease of administration, it seems that the estate tax is simpler. Since the tax rate is not dependent upon how much is given to each beneficiary and the relationship of the beneficiary to the decedent, computation of the tax simply involves determination of the value of the total net estate and application of the graduated rates to that amount. Where the decedent has given

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212 For a good discussion of the relative merits of each type of tax see, "Inheritance, Estate and Gift Tax Service, State," op. cit., vol. 4, par. 1006-1007; see also, Groves, op. cit., p. 220. Much of the information in this section is drawn from these two sources.

several persons different interests in the same property, there is no need to value each interest and collect the various amounts of tax from each of the beneficiaries. It is necessary only to value the entire property and apply the tax rates. Difficult problems of construing the decedent's will to determine who received property interests so as to ascertain what class of rates is applicable and then determining the value of such interests are not present in the administration of an estate tax. Similar problems are not completely avoided because the decedent may hold a remainder or some future interest in property as a grantee or donee from another.

On the other hand, the inheritance tax permits a more precise concern to be taken for the welfare of those who were dependent upon the decedent. By granting larger exemptions to a surviving spouse and to minor children, a policy of favoring tax-wise gifts to those who may have greater relative need for the property can be carried out. The inheritance-type tax can be used to implement a state policy of inducing persons to leave their property to the natural objects of their bounty.

The sharp conceptual differences between the two types of death taxes have been blurred in some states by approximating their tax to the other type. For example, some states using the estate-type tax have provided that the tax shall be borne by the beneficiaries on some pro rata basis and shall not be paid out of the residuary. Provisions in the decedent's will concerning the source of funds for the death taxes due can also be used to a similar end.

A Gift Tax

All states, through their death taxes, impose a tax upon transfers which are testamentary and some which are not testamentary according to traditional property law concepts. Taxation of transfers in contemplation of death is a common example. However, death taxes impose a tax only upon gifts that are made by will and resulting from the laws of descent and distribution or are so much like such gifts that they are classed as testamentary in character. This means that a person can make substantial gifts of property during his life which are not subject to a death tax. Some persons argue that all gifts should be taxed by one statutory scheme and that it should not matter whether the gift was testamentary in character or not.[213] Whether the motivation was to tax all gifts without regard to their character or to close an avenue to avoidance of the death tax is not clear. Whatever the case, 12 states and the federal government have imposed a separate tax on non-testamentary gifts. In general, the gift tax rates are about three-fourths those for the death tax. If a property transfer is taxed under the gift tax, it is not again taxed under the estate tax. Texas does not impose a gift tax.

213 Groves, op. cit., p. 257; Wolf, "Estate Planning Since 1948," The Tax Magazine (Commerce Clearing House, March, 1951), pp. 193-205.

Transfers Subject to Inheritance Tax

The fact that the basic federal estate tax and the death tax laws of other states tax certain transfers which are not included under the Texas inheritance tax may raise the question whether the Texas inheritance tax law should be amended to tax some of or all such transfers.

To understand what effects, if any, the addition of certain transfers as taxable under the Texas inheritance tax would have, it seems desirable to review the relationships among the federal estate tax, the Texas inheritance tax, and the Texas additional inheritance tax. Federal law grants the taxpayer a credit on the taxes due under the federal estate tax for all state death taxes up to an amount representing 80 per cent of amount due the federal government. This federal credit is applicable only to taxes due under the federal estate tax of 1926, commonly referred to as the basic estate tax; the substantial portion of the federal estate tax imposed upon an estate results from the additional federal estate tax to which the 80-per-cent credit provision is not applicable.

The rates and coverage of the Texas inheritance tax are not equal to those of the basic federal estate tax; in fact, they are not such as to approximate the full amount of the federal credit. Thus, Texas has imposed an additional inheritance tax which insures that the Texas tax always absorbs the full federal credit. The thought is that the taxpayer has to pay the tax anyway; so he may as well pay it to Texas as to the federal government. Furthermore, the federal law intended that the states should so design their death tax laws.

If an estate is liable for taxes under the basic federal tax, the two Texas laws operate in the following way. The inheritance tax law is applied and the amount due from each beneficiary is determined; then the additional inheritance tax statute is applied to impose a tax representing the difference between that due under the basic inheritance tax and 80 per cent of the amount due under the basic federal tax. This additional tax is then assessed against the beneficiaries taxed under the basic Texas tax pro rata, according to the amount they owe under the latter statute. In a particular case, the additional inheritance tax is used because the effective rates of the inheritance tax are below those of the basic federal tax, because certain transfers were taxed under the federal act which were not taxed by the Texas inheritance tax act, or for both reasons.

It can be seen that the use of the Texas additional inheritance tax to absorb the full 80-per-cent federal credit results in taxing transfers not subject to the basic Texas tax. An expected reaction, then, to any proposal to extend the coverage of transfers subject to the inheritance tax would be that it is unnecessary because if the transfer escapes the death tax under the inheritance tax, it will be taxed by virtue of the additional inheritance tax. It could be argued that any effort to amend the law to make additional transfers subject to the inheritance tax serves no other purpose than giving symmetry to the law -- a commendable but fruitless effort.

However, there are at least two factors in the tax environment to indicate that inclusion of additional transfers as subject to the Texas inheritance tax could have a substantial effect. If an estate includes a transfer that is subject to the federal tax but is not subject to the basic Texas death tax, a certain unfairness in treatment of the beneficiaries may result from application of the additional inheritance tax. If such a transfer is to a person who is taxed under the inheritance tax, the tax due the state under the additional inheritance tax will be assessed against the beneficiaries who owe taxes under the basic inheritance tax. In other words, in such a case one person will receive a gift upon which he bears no state tax, the tax upon the transfer being paid by the other beneficiaries. A basic principle of the Texas inheritance tax is that the beneficiaries bear the tax in proportion to the size of the gifts received; application of the additional inheritance can do violence to this principle in a number of situations. However, it should be noted that the apparent unfairness so created may, in practice, be ameliorated by a provision in the decedent's will directing what funds shall be used to pay the death taxes and by the tendency of administrative practices to treat the tax liabilities as those of the estate and not of individual beneficiaries. This encourages the beneficiaries to work out mutually satisfactory methods for paying the death taxes.

The addition of transfers subject to the Texas inheritance tax would also have an important effect upon estates upon which no federal tax is due under the basic federal estate tax law. In such cases, the additional inheritance tax does not come into operation and so only the transfers expressly taxed by the basic Texas tax are included. Deductions from the decedent's gross estate to compute the net estate upon which the federal tax is computed include an exemption of $100,000. [214] It can be seen, then, that a number of moderate sized estates will not be taxed under the basic federal estate tax but will be subject to the Texas inheritance tax. The addition of transfers subject to the inheritance tax would not only affect estates upon which no federal tax is due but also those upon which the tax due is relatively small.

214 26 U.S.C.A. 812 (a).

When the question is raised whether a certain type of transfer should be added to those subject to the Texas inheritance tax, it would seem that the essential policy judgment to be made is whether it is like, in purpose and character, transfers which are taxed. If it is of the same nature, then its exclusion may be considered a form of tax discrimination. An indication is given here of some transfers not now subject to the Texas basic inheritance tax which could be considered if an inuqiry along these lines were undertaken.

Powers of Appointment

The Texas inheritance tax, it will be recalled, taxes the exercise of a general power of appointment by will. The disposition of property which results from failure of the decedent to exercise the general power of appointment is not taxed. As mentioned in section 3 of this chapter, some states and the federal government consider that a final shifting of economic benefits and burdens of property upon death occurs as much from the failure to exercise the power as from the exercise of a general power of appointment by will. Thus they also subject the transfer resulting from non-exercise of the power to a death tax.[215]

Apparently, unless the donee of the power exercises the power by will, it is not subject to the inheritance tax. For example, the exercise of a general power of appointment under circumstances which would make the gift either one in contemplation of death or to take effect in possession or enjoyment after death, if a property interest other than a power of appointment were involved, is not subject to the inheritance tax. The tax law is not absolutely clear on this question, but that seems its purport. It also seems to be the administrative result of the law. If a general power of appointment is considered as amounting to the beneficial interest in the property for taxing its exercise by will, the question might be raised whether it should be similarly treated when it is exercised in other ways testamentary in character.

In order for a power exercised by will to be classed as a taxable transfer, it must be general. The question might be raised whether the classification of powers as general or special for purposes of property law are adequate for the needs of tax law. A power might be classified as special according to general property law but might be so like a general power when the policies underlying the taxation of general powers of appointment under the death tax are considered that it would be difficult to rationalize why one is taxed and the other is not. The federal estate tax deals with the problem of a consistent classification of powers in view of the realities of tax law by providing a definition of general powers for taxation purposes.[216] Some states,

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215 General powers created on or before October 21, 1942, are taxed by federal government only if exercised; however, those created after that date, whether exercised or not, are taxed. 26 U.S.C.A. 811 (f) (1951 Pocket Part).

216 26 U.S.C.A. 811 (f) (3) (1951 Pocket Part).

including California, tax both general powers of appointment and at least some special or particular powers.[217]

Transfers by Right of Survivorship

Texas does not expressly tax transfers resulting from a right of survivorship. As explained in section 3 of this chapter, situations involving rights of survivorship are sometimes taxable as gifts to take effect in possession or enjoyment after death. However, the usual joint tenancy situation is not subject to the inheritance tax. For example, the father gives a ranch to his two sons and provides that upon the death of one the other shall own the entire ranch. When the first son dies, it could be considered that a shifting of interest in the ranch occurs in favor of the surviving son. The federal government and a number of states have express provisions taxing acquisition of full title to the ranch by the second son as a result of his being the surviving joint tenant.

This discussion has been directed primarily to a consideration of transfers which are subject to the basic federal tax but which are not subject to the Texas inheritance tax. Any deliberation of the merits of taxing a transfer not taxed by the federal basic estate tax would involve additional considerations. Among other things, the question of the federal credit provision would be pertinent.

Exemptions

The exemptions or deductions used in the Texas inheritance tax seem to involve at least two considerations. First, administration of the tax is simplified by taxing only gifts above a certain amount. If all transfers of property testamentary in character were taxed, no matter what the value of the property involved, the tax administrator would be concerned with a very large number of estates which would yield little more than the cost of collecting the tax. By a proper establishment of deductions or exemptions, the tax administrator can be assigned the task of collecting a death tax only from estates involving a significant amount of money. Exemptions may also be a recognition of the fact that property of deceased persons with nominal means is informally distributed; any attempt to impose a death tax in such cases would pose a great enforcement problem.

Second, the exemptions seem also to involve a judgment that most persons in the given relationship to the deceased will have certain needs which they are dependent upon the gift to meet and that the state should not deprive them of such support through its tax policy. This consideration would

217 Calif. Revenue and Taxation Code, sec. 13693 (1944).

seem to have primary application to gifts to the surviving spouse, children, and parents of the decedent.

It has been previously mentioned that, in general, exemptions granted by the Texas inheritance tax are fairly liberal in comparison with those of other states. This might indicate a re-examination of the exemptions to determine whether they should be reduced.

On the other hand, reasons may exist for increasing the exemptions, at least with regard to certain beneficiaries. If an exemption involves a legislative judgment as to the needs of the beneficiary and it is remembered that the dollar amounts were set in the 1923 law, it would seem that the expression of that judgment in a dollar amount in 1923 would not be adequate in view of the marked increase of living costs in 1952. Of course, it should be remembered that taxes are levied to yield revenue and that revenue needs may be proportionally greater today than they were in 1923; so legislative judgment concerning this tax might be that it justifiably imposes a greater burden than at the earlier date.

To the extent that exemptions to class A beneficiaries represent an effort to permit the decedent to care for the needs of those dependent upon him, it seems that the present law only approaches that end. Some states, for example, classify children as "minor children" and "others" and grant a greater exemption for gifts to minor children upon the basis of the dependency policy. Texas grants the same exemption to a child, whether or not he is a minor. Any attempt to make actual dependency upon the decedent the criteria would create sizable administrative problems.

Texas, in common with several states, grants only one exemption based upon the kind of property transferred -- the insurance exemption of $40,000 if the proceeds go to a named beneficiary. Because an insured will usually name as beneficiary a person dependent upon him or will care for persons dependent upon him the insurance exemption seems also to be an indirect method of supplementing the exemptions granted to provide for those dependent upon the decedent. The facts that the insurance exemption is significantly greater than any of the other exemptions, that it is the only one based on the kind of property transferred, that it has been removed from the federal act from which Texas borrowed it, and that a number of states do not grant such an exemption may indicate that it deserves re-examination. To the extent that it serves a policy relating to decedent's dependents, the rise in cost of living since its inception in 1939 may indicate that the exemption should be increased. It seems that the insurance exemption represents the expression of a state policy to favor accumulation of an estate to care for one's survivors through insurance.

Discriminations Among Taxpayers

When a tax statute develops discriminations among taxpayers for which no apparent reasonable bases can be found, interest in such discriminations can be expected. Frequently, these discriminations were not anticipated when the law was enacted.

At least one apparently unintended discrimination may be found in the Texas inheritance tax law. An illustration will help in understanding the situation. A and B die domiciled in Texas, each leaving an estate of $300,000 divided equally among three beneficiaries. All of A's property is so situated as to be subject to the Texas tax, while only one-half B's $100,000 gift to each of his beneficiaries is subject to the Texas tax. In this situation, B's beneficiaries will be entitled to the exemptions granted by both Texas and the other state which taxes the transfers, and they will pay their taxes on the basis of lower rate brackets in each state. This means that B's beneficiaries will pay less than one-half the tax A's pay. In a sense, A is penalized for investing all his accumulated wealth in Texas.

Seven states have sought to give fairer treatment in these circumstances by calculating the tax as if B's entire estate were taxable in Texas. Under this approach, each of B's donees would be entitled to the applicable exemption from their $100,000 gifts, the rate applicable to the difference would be applied, and then, since one-half the gift is subject to the Texas tax, the amount of the tax found due would be divided by two. The beneficiaries would then pay this amount. The fact that the inheritance tax uses exemptions and rates which increase with the size of the gift is felt by these seven states to require such calculation of the tax to prevent discrimination against beneficiaries whose gifts are entirely taxable by one state. This approach is used in the Texas additional inheritance tax in allocating the portion of the federal credit due Texas if the decedent's property is subject to a death tax by more than one state.

Reciprocal Exemption for Charitable Gifts

A related but somewhat dissimilar situation arises with regard to charitable gifts. The Texas inheritance tax provides that gifts to religious, charitable, and educational institutions are exempt if the gifts are limited to use within the state. If they are not so limited, gifts are not exempt. Some states have provided a reciprocal exemption in such cases. For example, if a California decedent makes a gift to a Texas charity, the reciprocal exemption provides that California will exempt such a gift if Texas exempts gifts by Texas decedents to California charities. If desired state policy is to induce gifts to Texas charities, then the present law seems well designed to attain that purpose; however, if desired state policy is merely to induce charitable bequests, some change in the present law seems appropriate.

Obstacles to Efficient Administration

The yield of a tax is influenced by adequacy of administrative machinery and techniques which the tax law provides. If the powers of the tax administrator are not properly fashioned, the tax will not yield the revenue it should, and the cost of collecting the revenue it does produce will be higher than necessary. For that reason, a legislature interested in the full and fair collection of the taxes imposed may be concerned with removing any obstacles to effective administration. Several areas in the operation of the Texas death tax may be considered to involve administrative difficulties.

Double Domicile

Occasionally, two or more states find that the decedent was domiciled in their state upon his death, and upon that basis, they all impose a death tax upon transfers of the same property. As explained in section I of this chapter, there is no way to get a determination of the decedent's domicile which is binding on all states except in the unusual situation where tax claims of all the states exceed the resources of the estate. Some state legislatures have attempted to deal with this problem by authorizing their tax administrators to negotiate compromises with the other states which claim to be domicile of the decedent at his death. If this negotiation fails, authority exists for submission of the controversy to a board of arbiters for the finding of a single domicile.[218] Express provision of a practicable method for dealing with this thorny but infrequent problem may be considered advisable to avoid hardships for heirs and beneficiaries of the nomadic decedent.

Contingent Interests

Administration of the Texas inheritance tax in strict accordance with the apparent intent of the tax statute and with traditional property concepts involving transfers of non-possessory property interests, particularly contingent interests, appears not to be practicable. At least, the tax administrator ignores the non-possessory interest, if he considers it too remote, and taxes the transfer of it by including its value in that of the property transferred to one receiving the more immediate interest in the property. It seems clear that this practice removes certain thorny questions in the enforcement of the tax and results in the more immediate and certain collection of a tax on the transfers. However, as mentioned when this matter was explored in the final portions of section 3 of this chapter, such practices may result in the assessment of a lower tax in some cases than would be the case if the apparent technical requirements of the law were followed. But because of certain practical difficulties, following the strict letter of the law might result in less revenue being collected than yielded under current administrative practices.

218 56 Harv. L. Rev. 482 (1942).

Some states, apparently recognizing the difficulty of adhering to traditional legal concepts in this area, have made special provision for handling inheritance taxation of certain non-possessory interests. Three methods are set out in some detail in the previous discussion in section 3. Essentially, they involve provisions for deferring final determination of taxes due until the various contingencies have occurred.

All three methods used by these states result in keeping the tax files on certain estates open for a number of years. Thus it might be concluded that whatever revenue sacrifices which flow from Texas practice are preferable to keeping open the tax file for a number of years, with the possibility that the case may be neglected and revenue lost. Whether it would be prudent to adopt a procedure similar to any of these is, then, a debatable question. However, it may be desirable to obtain more explicit legislative direction than now exists in Texas law for the handling of problems that arise in this area.

Optional Valuation Dates

The Texas inheritance tax act provides that the property shall be appraised at its actual market value at the death of the decedent, or if it has no market value, then at its real value at the decedent's death. The tax, then, is paid on the basis of values existing at the decedent's death with resources marshaled at some subsequent time. This may cause a hardship to beneficiaries, particularly in a period of falling prices and when final determination of the tax and distribution of the estate's assets are delayed for several years as the result of a will or tax contest. Such hardships can present difficulties in the collection of the tax.

The federal estate tax deals with this problem by offering several optional valuation dates, including date of death, date of sale (if the property is sold), date of distribution (if property is not sold), or a date one year after death if the property is undistributed at that time.[219] It might be appropriate to consider whether the addition of some such provision to the Texas law might help the fair and efficient administration of the tax.

Perpetual Tax Lien

Apparently, if the Texas death tax due is not paid, the lien securing its payment may be enforced against property of the estate at any time against any possessor of the property. It seems that it never is extinguished because of age. This gives very adequate protection to the state's tax claim. However, the Texas laws have many manifestations of a policy against perpetual encumbrances, and the task of keeping permanent records for estates on which all death taxes have not

[219] 26 U.S.C.A. 811 (j).

been paid and on the property of such estates is sizable. In view of these considerations, it might be appropriate to consider providing for the termination of liens to secure payment of the tax after a certain number of years. California, for example, provides that the tax lien is released in favor of an innocent purchaser of the property unless suit to collect the tax is brought by the state within five years after it becomes due.[220]

Notice by Insurance Companies

Location of taxable estates is not an easy matter. If all insurance companies chartered in Texas or doing business in the state were required to give the Comptroller notice of the allowance of life insurance claims, material assistance would be given in the administration of the tax. Furnishing the Comptroller with the names of the insured and beneficiary and the amount of the policy would probably not be too great a burden on the life insurance companies and would eliminate one item from the Comptroller's investigation.

Inspection of Records

The Texas inheritance tax laws do not expressly give the Comptroller authority to inspect books of account or other private records pertinent to the determination of the tax. In view of the fact that the structure of the Texas tax laws is such that there are no provisions giving general administrative powers for all taxes to the tax administrator, this deficiency may be noteworthy. The Comptroller has obtained good co-operation from custodians in examining pertinent records, particularly banks with regard to their accounts. However, it might be desirable to grant the Comptroller power to get such co-operation from all persons.

Field Examiners

The seven field examiners of the inheritance tax division close out an average of more than one taxable estate per working day. Given the task of investigating an estate and appraising its property, this would seem to be a considerable work load. Difficult legal and factual problems arise regarding some estates. The difficulties of these tasks are aggravated if the estate is of such moderate size that no federal estate tax accrues and the more simply-administered additional inheritance tax does not come into operation.

In view of these factors, attention may need to be given to whether the number of field examiners should be increased. In view of the current competitive labor market, it may also be desirable to consider what legislative measures need to be taken to assure that any additions to the field force are competent to perform their difficult duties.

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220 California Revenue and Taxation Code of 1939,as Amended, ch. 9, art. 1, sec. 14303.

General Considerations

The problem areas indicated in this section are not intended to be exhaustive, nor are the possible methods for dealing with the problems intended to cover all the alternatives if a change is desired. This material is designed only to stimulate consideration and to set out some of the areas of the tax law that may be worthy of re-examination.

Close reading of two death tax statutes reveal that legislative policy is not made as clear as it might be. If any revision of this tax is ever undertaken, some attention might be given to making a clearer, more orderly, and more complete presentation of legislative policy in the law.

A general word of caution regarding revisions of the inheritance tax laws may be in order. It should be remembered that lawyers and other counselors plan the disposition of clients' estates against the background of the death tax laws, both state and federal. In contemplating any change in the Texas inheritance tax laws, consideration should be given to the effects any changes will have upon estates for which dispositions have been planned. However, this factor is not so important as to dictate that no change should ever be made in the Texas inheritance tax laws. Each proposed change needs to be examined separately in this light because the degree of impact upon estate planning will vary from case to case.

Chapter IV

STOCK TRANSFER TAX

SECTION I - HISTORICAL AND LEGAL DEVELOPMENT

Security markets and exchanges have existed for centuries. The beginning of organized exchanges developed from weekly meetings of men who acted as intermediaries between sellers and buyers, and as business interests developed, associations were formed to expedite the increased volume of transactions. With the wider distribution of wealth and the development of joint stock enterprises, organized security exchanges grew rapidly. The exchanges furnish a means by which transfers of securities may be readily effected, thus providing a mobility of capital without which the function of corporate enterprises would be greatly curtailed. Stock transfer taxes are a direct, though incidental, result of the development of securities exchanges, particularly of the New York Exchange. Any consideration of these taxes must be made with understanding of the growth and development of the exchanges.

Organization of the New York Exchange

Although London is generally considered the greatest international stock market in the world, the New York Stock Exchange provides the principal market in the United States. [1] The New York Exchange traces its history to the 1790's, but it was not until 1817 that the New York Stock Exchange Board was organized. Since the organization of the Exchange, the economic history of the United States has been recorded in the types of securities offered on the board. Beginning with the stocks of the first United States Bank and later local incorporated banks, the New York Exchange has provided a convenient place for investors to effect their transactions. Later, economic developments brought about needs for capital to finance state construction of canals and waterways. Soon afterward, railroad securities were traded, and with the development of the coal and petroleum industries appeared important mining and oil stocks. At the close of the Civil War, utilities and industrial securities made an initial appearance. Increase in the volume transacted and in the total listings continued throughout the 19th and into the 20th Century. [2]

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[1] In 1949, the New York Exchange effected the sale of some 353 million shares of the total United States transactions involving some 478 million shares. Concerning volume, the New York Curb Exchange was second in importance and recorded a total of 68 million shares involved in transactions in 1949. Other important organized exchanges are in Salt Lake City, San Francisco, and Los Angeles.

[2] Much of the information for the preceding discussion was taken from *The Encyclopaedia Britannica* (Chicago: University of Chicago, 1945), vol. 21, pp. 419-422.

In the development of the New York Exchange after the turn of the Century, the volume of transactions increased steadily from some 164 million shares in 1910 to more than 225 million in 1920. The most rapid increase in volume occurred through the 1920's, and the figure exceeded one billion shares in 1929. Largely as a result of the depression, the number of shares involved in transactions declined in the 1930's, and by 1939 the volume was reduced to some 262 million shares. During the last ten years, an annual total of from 100 to 400 million shares have been traded on the New York Exchange.[3] The domination of the securities market by the New York Exchange is of considerable significance in a consideration of stock transfer taxes. See Table Stock - I.

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[3] United States Department of Commerce, *Statistical Abstract of the United States, 1950* (Washington, D.C.: U.S. Government Printing Office, 1950), p. 422.

TABLE STOCK - I

Volume of Stock Transfers on New York Exchanges

Year	N. Y. Stock Exch. Trans.	N. Y. Curb Exch. Trans.	N. Y. Volume as % of all Regular Exchanges
	(Shares)	(Shares)	
1929	1,124 800, 410	476, 140, 375	
1930	810, 632, 546	222, 270, 065	
1931	576, 765, 412	110, 313, 687	
1932	425, 234, 294	57, 159, 897	
1933	654, 816, 452	100, 916, 602	
1934	328, 845, 634	60, 050, 695	
1935	381, 635, 752	75, 747, 764	
1936	496, 046, 869	134, 845, 196	
1937	409, 464, 570	104, 178, 804	
1938	297, 466, 722	49, 640, 238	67.77
1939	262, 029, 599	45, 729, 888	65.95
1940	207, 599, 749	42, 928, 377	66.31
1941	170, 603, 671	34, 656, 354	69.35
1942	125, 685, 298	22, 301, 854	67.27
1943	278, 741, 765	71, 374, 283	72.10
1944	263, 074, 018	71, 061, 783	71.98
1945	377, 563, 575	143, 309, 392	67.92
1946	363, 709, 312	137, 313, 214	62.46
1947	253, 623, 894	72, 376, 027	63.67
1948	302, 218, 965	75, 016, 108	66.14
1949	272, 203, 402	66, 201, 828	64.92

SOURCE: The World Almanac and Book of Facts for 1951, "N. Y. Stock Exchange Transactions and Seat Prices," (New York: New York World-Telegram and The Sun, 1951), p. 686.

United States Department of Commerce, Statistical Abstract of the United States, 1950 (Washington, D. C.: U. S. Government Printing Office, 1950), p. 422.

Federal Taxation on Transfer of Securities

The sale of securities was first considered an acceptable basis for federal taxation in the United States before the end of the Civil War. As part of a general document stamp tax enacted in 1864 by the 38th Congress, a tax was assessed on the sale of all securities by brokers. [4] A tax of ten cents was levied on the sale of each share of stock, regardless of par value, market value, or volume transacted. The tax offered few exemptions, and heavy monetary penalties were provided for evasion and counterfeiting. The tax remained in effect only until 1872, when all stamp taxes enacted by the 38th Congress were repealed. [5]

As part of a tax program to defray increased federal appropriations resulting from the Spanish-American War, a federal stamp tax on securities was again levied in 1898. The rate was five cents on each $100 face (par) value, or any fraction thereof. [6] Before the tax was repealed in April, 1902, [7] the rate had been reduced to two cents per $100 face value, or fraction thereof. [8] It may be noted that both federal revenue acts which were in effect before World War I and which included a tax on stock sales were primarily war-time measures and not permanent tax programs.

The First State Stock Transfer Tax

Before a tax on the sale of securities was included as part of the permanent federal tax program, three states had imposed a stock transfer tax. The first, logically enough, was New York. The tax was enacted there in 1905, [9] at which time the state, and more specifically New York City, was rising rapidly as a world financial center. The volume of business on the New York Exchange had grown to considerable proportions by that time, and the Exchange was already recognized as the foremost securities market in the nation. To take advantage of this unique position, New York incorporated the stock transfer levy in its permanent tax program as a means of reaching lucrative revenue sources not theretofore available through tax statutes.

This new state tax was perhaps as much a product of the times, however, as a result of the need for additional revenues. States throughout the country were searching for new tax sources in an effort to distribute the tax burden more equitably than was possible under the property tax, which had been the mainstay of state

[4] 13 Stat. 173 (1864), sec. 170, p. 299. The enactment also provided for a tax on all mortgages, dues, and other conveyances.

[5] 17 Stat. 315 (1872), sec. 35, p. 256.

[6] 30 Stat. 448 (1898), sec. 6, p. 458.

[7] 32 Stat. 500 (1902), sec. 7, p. 97.

[8] 31 Stat. 806 (1900), sec. 8, p. 942.

[9] Laws of the State of New York, 1905, vol. 1, ch. 241, p. 475.

systems during the 19th Century. Large corporations had grown up on the American scene, and a public fear of trusts was prevalent. Largely as the result of unscrupulous business activities which were quite common about the turn of the century, anti-trust legislation had just been enacted by Congress. Coinciding with the passage of this new tax were disclosures of the Armstrong Committee, which was investigating the insurance business in New York. A new tax on business was a logical product of the period. The tax was based on $100 face (par value)or fraction thereof. A rate of two cents, the same as that previously levied by the federal stamp tax, was assessed in the original New York statute. Indications are that exemptions and penalties provided in the New York tax were also largely derived from previous federal taxes on the sale of securities.

At about the same time a public feeling had developed in the Commonwealth of Massachusetts that owners of intangible property were escaping their just share of the common tax burden. As a result, the idea of a stock transfer tax was appealing, and a bill (House Doc. No. 830) patterned after the New York law was introduced in the Massachusetts Legislature as early as 1906. However, there was a long struggle before the Massachusetts Legislature finally adopted the tax. A similar proposal introduced each year from 1909 to 1913 was rejected on each occasion. Finally, in 1914, the general court enacted its first stock transfer tax.[10]

In several important respects, the Massachusetts enactment was an attempt to apply the New York tax within the boundaries of the former state. This was accomplished by enacting a similar tax. But in terms of revenue, the Massachusetts tax left much to be desired. The fact that Massachusetts failed to develop as lucrative a source as New York was chiefly the result of concentration of stock transactions on the New York Exchange.

In the next year, 1915, Pennsylvania also attempted to obtain a revenue source similar to that developed in New York by the stock transfer tax.[11] But like Massachusetts, Pennsylvania never developed a financial center comparable to that in New York City. Mostly as a result of differences in environment, the stock transfer taxes of Massachusetts and Pennsylvania both failed to provide anything like the amount of revenue developed in New York. See Table Stock - 2.

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[10] Acts and Resolves of Massachusetts, 1914, ch. 770, p. 883. Much of the information for the discussion concerning development of the stock transfer tax in Massachusetts was obtained from a letter dated August 17, 1951, addressed to Mrs. Fay Young, Texas State Library, by Dennis A. Dooley, State Librarian, the Commonwealth of Massachusetts.

[11] Laws of the Commonwealth of Pennsylvania, 1915, vol. 1, no. 372, p. 828.

TABLE STOCK - 2

Revenue Receipts From Stock Transfer Tax, by States -- 1942 - 1950
(in dollars)

	(2)	(3)		(4)	(1)	(1)
Years	N. Y.	Mass.	Penn.	Tex.	Fla.	S. Car.
1950	19,869,934	329,558	194,191	271,180	2,554,281	658,729
1949	18,127,071	297,645	149,937	201,466	2,122,983	623,288
1948	15,676,165	280,713	170,753	160,317	2,177,254	657,138
1947	22,404,998	287,008	221,157	103,742	1,997,422	639,581
1946	26,609,782	407,234	298,874	110,384	1,633,680	484,720
1945	20,363,653	341,902	373,433	103,593	1,089,088	316,699
1944	16,870,567	264,802	534,787	67,180	947,679	308,537
1943	9,626,928	163,269	281,147	91,113	643,729	241,741
1942	11,958,301	242,685	312,240	67,488	705,505	278,406

(1) Documentary stamp tax, including stock transfer tax.

(2) New York, 1943, for nine-month period.

(3) Massachusetts, 1943, for seven-month period.

(4) Texas figures computed by Comptroller's Office, Austin, Texas.

SOURCE: Tax Systems, CCH, 12th ed., 1950, pp. 315 - 344; Supplement to Twelfth Edition of Tax Systems, CCH, 1951, pp. 66-78.

It is interesting to note that the use of no-par value stock by corporations gained national acceptance during this period, partly as an aid to corporate financing and partly to avoid the full effects of such taxes as the corporation franchise taxes, which were generally based on par value. The first statute authorizing no-par value stock was passed in New York in 1912, [12] and by 1922 there were 23 states with such statutes. [13] However, the use of no-par stocks preceded these enactments by a considerable time. As a matter of fact the device of no-par value for stock issue is known to have been used as early as the first decade of the 19th Century in the incorporations of the early New England turnpike companies. [14]

To meet the problem presented by the spreading use of no-par value stock, New York amended its stock transfer tax law in 1913 to make provision for "stock with no designated monetary value." [15] Later enactments in other states borrowed this provision.

Resumption of Federal Taxation

Although three states enacted stock transfer taxes as part of a general tax program between the Spanish-American War and the entrance of the United States into World War I, the federal government during this period refrained from taxing the transfer of securities until a proposed increase in emergency expenditures demanded new sources of revenue. Therefore, in the Revenue Acts of 1914 and 1917, a federal stamp tax was again levied on the transfer of stock at a rate of two cents per $100 par value, or any fraction thereof. [16]

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[12] Laws of the State of New York, 1912, 135th Session, ch. 351, p. 687.

[13] See *American Refining Co. v. Staples,* 260 S.W. 614, 615 (Tex. Civ. App., 1924).

[14] Charter of the Worcester Turnpike Corp., Laws of Massachusetts, 1806, ch. 67, p. 15; *Middlesex Turnpike Co. v. Swan,* 10 Mass. 384 (1813).

[15] Laws of the State of New York, 1913, vol. 3, 136th Session, ch. 779, p. 1968. For a discussion of the adoption of no-par value as a basis for issues of stock, see *The Encyclopedia Britannica* (Chicago: University of Chicago, 1945) vol. 21, p. 418; Cook, *"Watered Stock"- Commissions - "Blue Sky Laws"- Stock Without Par Value,* 19 Mich. L. Rev. 583 (1921); Morawetz, *Shares Without Nominal or Par Value,* 26 Harv. L. Rev. 729 (1913).

[16] 38 Stat. 331 (1914), sec. 22, p. 745; 40 Stat. 63 (1917), sec. 807, p. 322.

In following the policy established by the states with stock transfer taxes, the federal tax was levied on the transfer of stock rather than only on the sale. Also similar to the state provisions were the standard exemptions provided, the adhesive stamps to be affixed, and the penalties enumerated for specific evasions. In addition to the tax assessed on par-value stock, a two-cent levy was placed on the transfer of each share of stock with no par value. This provision also reflected the policy established by the states. After being included in the Revenue Acts of 1918, 1921, and 1924, the stock transfer levy became a permanent part of the federal tax program. [17]

Documentary Stamp Taxes

Soon after the federal government gave the stock transfer tax a permanent and established place in its scheme of taxation, South Carolina imposed a tax on the transfer of securities.[18] As part of the documentary stamp tax, an assessment on the transfer of stock was levied, and various rates were applied to the transfer of original issues, no-par value stock, par-value shares, and capital stock with and without par value. Payment was to be made through purchase of stamps from county officers, and no alternate procedure for payment was offered.

Available records do not indicate that any stock transfer taxes were enacted between passage of the South Carolina tax in 1923 and enactment of a similar documentary stamp tax by Florida in 1931. Although the Florida tax was assessed at the relatively higher rate of ten cents on the transfer of shares of stock based on $100 par value and on each stock transfer with no-par value, [19] the collection procedure closely paralleled that employed by other states assessing stock transfer taxes.

When South Carolina and Florida considered the adoption of the stock transfer tax, these Southern states had the benefit of the long experience of New York, Massachusetts, and Pennsylvania. It was undoubtedly obvious to them, as revenue records clearly disclosed, that the stock transfer tax could be a significant revenue-raiser only in New York. It was natural, then, that they adopted a tax with a broader base, although stock transfers were included among taxable activities. However, to the extent that the South Carolina and Florida taxes dealt with stock transfers, their features were borrowed from the laws of New York, Massachusetts, and Pennsylvania. Basis was still par value of stock (except for no-par stock), and no alternative method of payment to stamp-affixation was provided. That the broader-based documentary taxes of the two Southern states proved more lucrative than the stock

[17] The present federal stock transfer tax is imposed by the Revenue Act of 1926, tit. VIII, reg. 71, art. 2, 26 USCA 1802 (b).

[18] For the text of the original enactment, see Acts of South Carolina, 1923, part 1, no. 11, p. 12.

[19] For the text of the original enactment in 1931, see General Laws of Florida, vol. I, ch. 15787, p.1398.

transfer tax alone has been clearly demonstrated in the subsequent history of these taxes. Collections from the documentary taxes of South Carolina and Florida in recent years have consistently exceeded, by a considerable margin, collections from the stock transfer taxes of Massachusetts, Pennsylvania, and Texas. See Table Stock - 2.

Texas Note Tax and First Stock Transfer Tax

Following, in part, the examples of South Carolina and Florida, Texas in 1936 enacted a stamp tax on notes and mortgages.[20] Omitting the stock transfer features of the documentary taxes in those states, Texas adopted the deed and mortgage recording features. This tax law was similar to those of several other states which had not enacted a stock transfer tax but had, in one form or another, adopted taxes similar to the documentary tax laws of South Carolina and Florida and to the mortgage-recording and documentary taxes of New York and Pennsylvania, which were separate statutes from their stock transfer laws.

In 1935, Washington enacted a tax on stock issues and transfers, but the section which included the stock transfer tax was vetoed by the governor.[21]

For almost five years, the note tax was effective in Texas and brought in revenues ranging near $400,000 annually. However, in 1941 this tax was repealed because it ". . . discriminates against various State banking, mortgage, and loan companies. . ."[22] A few months later, the Attorney General ruled that the repeal was not effective,[23] but subsequently the Court of Civil Appeals held the repeal valid,[24] and the note tax law disappeared from the state's tax program.

In its place--actually enacted before the note tax law was repealed--was put a stock transfer tax adopted as part of the omnibus tax bill of 1941.[25] When the omnibus bill (House Bill 8) was originally submitted, no provision was made for a stock transfer tax, but later in a Senate committee substitute such a tax, similar to those of the northeastern states, was included.[26] With an amendment concerning the exemption of stock transferred by building and loan associations,[27] the tax became law.

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[20] Acts 44th Leg., 3d C.S. 1936, ch. 495, p. 2040, art. IV, sec. 9.

[21] Washington State Laws, 1935, vol. 1, ch. 74, sec. 61.

[22] Acts 47th Leg., R.S. 1941, ch. 449, p. 723.

[23] Op. Tex. Atty. Gen. (August 7, 1941).

[24] Community Public Service Co. v. James, 166 S. W. 2d 395 (Tex. Civ. App., 1942, writ ref'd.)

[25] Acts 47th Leg., R.S. 1941, ch. 184, art. XV, p. 296.

[26] Senate Committee Substitute, 47th Leg., H. B. 8, p. 83.

[27] Senate Journal, 47th Leg., 1941, p. 995.

Copying features of the early taxes in the northeastern states, the stock transfer tax in Texas, as originally enacted, imposed a tax on all sales or transfers of shares of stock in domestic or foreign corporations. A rate of three cents was imposed on the basis of $100 par or face value, and the rate was also three cents on each share if there was no par value. The tax was made payable by use of adhesive stamps, which were to be obtained, affixed, and canceled by the person effecting the transfer. No tax was to be collected when securities were deposited as collateral for a loan, when stock was transferred to a broker, or when no act effecting sale or transfer was accomplished in the state. In addition, building and loan associations chartered in Texas and certain credit unions were specifically exempt. Stamps were to be prepared by the Comptroller and sold by the county clerk of each county in a manner prescribed by the Comptroller. Refund provisions were included. Failure to pay the tax was made a misdemeanor.

The fact that Texas repealed the documentary stamp tax in favor of a more narrowly based stock transfer tax may be considered somewhat surprising in that the actions reversed the general tendency in other states to shift from stock transfer taxes to broader-based taxes on documents and intangibles. After the early stock transfer taxes of New York, Massachusetts, and Pennsylvania, all the more recent state taxes have been documentary or mortgage and note registry taxes. A few of them include transfer of stock as one taxable action among several others. Even in New York and Pennsylvania, such mortgages and note registry taxes have been used to supplement collections from the stock transfer taxes, and the addition of a mortgage registration tax was proposed in Massachusetts in 1951. Except in New York, the stock transfer taxes have consistently been lower revenue-raisers than the documents or mortgage and note registration taxes. Texas stands alone in its shift from the more lucrative mortgage and note tax to the stock transfer tax.

Another aspect of the 1941 Texas law which may be considered somewhat surprising was that, in borrowing from the statutes of the other states -- the evidence of which is apparent in the similarity of exemptions, penalties, methods of collection, and rates, it ignored a significant recent development adopted in other jurisdictions -- adoption of market value as the basis for the tax rather than the usually unrealistic par value used in the earlier statutes.

By use of market value, numerous issues of stock whose listed par value had been regularly and considerably below the selling price were made liable for a larger tax. Most important, the tax base had a reasonable relationship to value, which is rarely true in the case of the arbitrarily assigned par value.[28] See Table Stock - 3.

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[28] A similar problem as to whether par value or market value is the most meaningful evaluation of stock has also arisen in the franchise tax, the study of which is presented in another chapter of this report. Although both the franchise tax and the stock transfer tax are partly based on the value of corporation stock, one of the major distinctions between the two taxes is that the former is collected through the corporation and is a tax on the privilege of conducting business; the stock transfer tax is generally paid by the seller of the stock and is an assessment on the privilege of transferring stock.

TABLE STOCK - 3

Par and Current Market Value of Stock of Texas Corporations Listed on New York Stock Exchange or Curb Exchange

Name	Market Value (Sept., 1951)	Par Value
*Houston Lt. & Pwr.	18-3/8	No
**Humble Oil & Rfg.	128-1/4	No
**Kirby Petroleum	27-7/8	1
**Lone Star Gas	28-1/8	10
**Producers Corp.	2	1
*Reed Roller Bit	19-1/2	No
**Rio Grande Valley Gas	2-1/8	1
*Texas Gulf Sulphur	101-1/2	No
*Tex. Pacific Coal & Oil	46-3/4	10

* New York Stock Exchange

** New York Curb Exchange

SOURCE: Monthly Stock Digest (Data Digests, Publishers, New York, October, 1951); Austin, Texas, Office of Merrill, Lynch, Pierce, Fenner, and Beane.

The federal transfer tax went to a modified market-value base in 1932; New York made the change in 1933 and Pennsylvania some years later. Market value as a base was accepted because it was generally more realistic than par value. An additional reason for the change in New York, where the tax had been based "on each share of one hundred dollars of face value or fraction thereof," was the decision in People ex rel. Farrington v. Mensching.[29] The court held that such a rate was unconstitutional, being an arbitrary discrimination in favor of shares having a face value of $100. Under such a rate (two cents per share at that time in New York), a transfer of 100 shares of the face value of ten dollars each would be taxed two dollars, whereas a transfer of ten shares of the face value of $100 each would be taxed 20 cents, although the total face value of each block of shares was the same.[30]

In more recent years, another development of considerable importance in the administration of the stock transfer tax has taken place in New York and Pennsylvania. The method of tax payment, which in all states having transfer taxes was originally by affixation of stamps to the certificates on records involved, was changed. In 1945, Pennsylvania permitted payment of the tax in cash by members of organized stock exchanges.[31] New York followed suit the next year,[32] adding over-the-counter dealers not connected with any organized stock exchange to the category of those permitted to pay the tax in cash. Presently, the only stocks transferred with stamps in New York are those sold outside the organized markets and those sold by dealers who do not wish to pay in cash. When the cash method is used, daily reports are required. This alternative method of payment has eliminated much of the stamp cost for the states and has provided the taxpayer with a less cumbersome procedure.

Changes in the Texas Law

Few amendments have been made to the Texas stock transfer tax since its original enactment in 1941. The basis of the tax has not been changed, nor has the method of collection. However, changes in rate and additional exemptions have been made.[33]

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29 187 N. Y. 8; 79 N. E. 884; 10 L.R.A. (N.S.)625.

30 Francis T. Christy and D. H. McLean Jr., The Transfer of Stock (2d ed. and 1950 supplement, New York: Baker, Voorhis, and Co., 1940).

31 Laws of the Commonwealth of Pennsylvania, 1945, vol. I, no. 395, p. 1071.

32 Laws of the State of New York, 1946, vol. 1, ch. 692, p. 1370.

33 In 1943, Texas enacted a Uniform Stock Transfer Act which gave statutory recognition to the fact that title to certificates and shares of stock could be transferred by delivery of the certificates endorsed either in blank or to a specific person. Acts 48th Leg., R. S. 1943, ch. 397, p. 722.

The first change occurred in 1947 when an exemption for stock transferred as the result of orders issued by the Federal Securities and Exchange Commissions was provided.[34] The emergency clause of the act stated that the need for such an amendment was based on the fact that the federal stock transfer tax and other similar state taxes offered such exemptions. No other attempts to adjust the Texas law to that of the other jurisdictions has been made.

In 1950, as a result of the need for additional revenue to support state hospitals and special schools, the First Called Session of the 51st Legislature enacted an additional tax of ten per cent of the original three per cent.[35] This additional tax was at that time made effective through August 31, 1951, but it was made permanent in 1951. Thus the current rate is $.033 on each $100 of face value, or $.033 per share if no face value is given.[36]

The development of the tax law by legislative enactments has not been great. Most of the development has in practice been through interpretations of the law by the Attorney General. These have covered most phases of the application of the tax, and its scope has been quite specifically defined by opinions of the Attorney General. That the scope has been quite limited is readily apparent from a cursory observation of the law's operation. This will be discussed in later sections.

Little effort has been made to keep the Texas statute abreast of developments in similar taxes of other states, nor has there been any apparent re-evaluation of the scope of the tax since its initial enactment. The techniques and practices in the stock transfer business have changed greatly in the decade since enactment of the tax; yet the tax law remains virtually unchanged, providing consistently less than one-half of one per cent of the state's total tax revenue.

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34 Acts 50th Leg., R. S. 1947, ch. 238, p. 432.

35 Acts 51st Leg., 1st C. S. 1950, ch. 2, art. XIV, p. 25.

36 Acts 52d Leg., R. S. 1951, ch. 402, sec. XVII, p. 716.

SECTION 2 - ORGANIZATIONAL FORM

Primary responsibility for administering the stock transfer tax is placed by law upon the Comptroller. Sharing the burden with him are the county clerks, who by statute are assigned the collection phase of administration by virtue of their being designated to sell tax stamps. Completing the organizational structure for administration is the taxpayer himself, who is responsible according to the law for computing the tax owed and for initiation of tax payment by purchase and affixation of tax stamps.

In addition to the above-mentioned persons, the tax statute lists stock brokers and corporations chartered in Texas as agencies with responsibilities in administration. The law assigns certain and definite functions to each of the five entities.

Briefly, the concept of tax administration apparently envisioned by the taxing statute is as follows: The taxpayer, i. e., the citizen engaging in a taxable transaction of stock, is made responsible for computing the tax he owes and for making the necessary payment by purchasing tax stamps to be affixed to one of several documents as prescribed by the law. To make stamps conveniently available to him, and presumably to permit a sort of control, county clerks are designated to sell stamps. They are also required to keep prescribed records of stamp sales and to submit certain reports. Presumably as a means of cross-checking and evidently to make possible further controls for the tax administration, stock brokers in the state and corporations chartered in Texas are directed by the law to keep certain records showing all taxable transfers of stock.

Co-ordinating these various required activities and completing the collection process is the Comptroller, who designs the tax stamps, forwards them to the county clerks, receives the money, and has authority to inspect the various records required by the statute.

However, the actual administration of the tax is definitely less complex than the statute would indicate. In practice, approximately 90 per cent of all stamp sales are made directly to the taxpayer by the Gross Receipts Division of the State Comptroller's Office. Only 18 county clerks buy stamps on consignment from the Comptroller, and of these, only a few get stamps regularly. Three or four clerks who do not buy stamps on consignment do make occasional purchases.

Although some check is made on the records of county clerks in regard to stamp sales, the reports no longer require a record of names of purchasers. Reports are not always received from the counties. Whether brokers and Texas-incorporated companies maintain the records required by law is not known because no check is made of either group.

Thus, because of a number of developments which have come about in the stock transfer tax and which will be discussed in following sections, administration of the tax is very simple. Only the Comptroller, the taxpayer, and a few county clerks participate in the administration of the tax, and these have only small parts in the collection function. The enforcement function is virtually non-existent.

It is quite apparent that the substance has been removed from the form and that the administrative organization contemplated by the statute does not function in reality. How much of this is the result of the inherent nature of the tax and how much the result of changes which have come about in its application may be determined in the sections to follow.

SECTION 3 - ASSESSMENT

The stock transfer tax is a tax on certain transfers of proprietary interests in corporations. Transfers of obligations of corporations, such as ordinary bonds, are not taxed. It operates in an environment of a somewhat complicated marketing structure and marketing arrangements for the exchange of shares of stock. Transfers are taxed at the rate of 3.3 cents on each $100 or fraction thereof of the par or face value of shares with a designated value and of 3.3 cents per share of the shares without a designated value (no-par stock). The market or sales price of the shares is disregarded in computing the tax.

To understand how the tax operates, it is necessary to understand some of the ways in which transactions in shares are carried on, the different property interests whose transfer is subject to the tax, the different kinds of transfers which are taxed, the connection with Texas a transaction must have in order to be subject to the stock transfer tax, and the stock transactions expressly excluded from the tax's coverage. It is the purpose of the following discussion to present this material in the above order. Since there has been no reported judicial interpretation of the Texas stock transfer tax law, the analysis will be based upon interpretations by the Attorney General and construction placed upon similar laws in other states. Although the Attorney General's opinions, about half of them having been given in the first year of the tax, have dealt with many problems, substantial questions concerning the tax's coverage remain for which there is no judicial or administrative answer.

Marketing Corporate Stocks

Some understanding of the current practices in the sale of corporate stocks is necessary to an appreciation of the stock transfer tax. A survey, primarily of those aspects of marketing practices which affect the tax, is therefore presented. A person desiring to buy or sell stock may deal with (1) another individual investor, (2) an over-the-counter security dealer, or (3) a brokerage house. The choice of transaction will, to some extent, determine whether the transaction has a sufficient connection to Texas to subject it to the stock transfer tax.

Transactions Between Individuals

The simplest, but certainly not the most common, type of stock sale is that which transpires between two individuals who effect the transaction without the services of any intermediary, such as a broker. After the sale has been made, the seller hands over the certificates of stock to the buyer, and the buyer hands over the money to the seller. Customarily, the seller will endorse the certificates to the buyer; and the corporation whose stock was sold will be notified to change its records to show the buyer and not the seller as the owner of the stock and as the one to whom dividends should be mailed. The records showing current ownership of stock are called the transfer records or stock record books.

Obviously, this sales transaction may be carried on face-to-face or by mail, telephone, or telegraph; and in the latter instances, one party may be in Texas and the other in or out of the state. As will be explained later, the location of the parties during the transaction may determine whether a tax payment is due Texas.

Security Dealers

A more popular alternative open to individuals desiring to sell stock is the second possibility mentioned, over-the-counter security dealers. A large volume of stock sales is handled by over-the-counter dealers who are today located in most large cities. Such dealers serve the public and offer information concerning various types of securities and direct contact with some of the major stock exchanges.

Security dealers, like individuals, act as buyers or sellers in most stock transactions. When an individual sells stock at his dealer's office, the dealer himself is the purchaser, and the transaction made through the dealers is generally reflected on the stock record books of a corporation. Dealers, while maintaining an active interest in stocks listed on registered exchanges, usually tend to concentrate in unlisted stocks. There is no real difference in this transaction and that first described, except that a security dealer is in the business of buying and selling stocks.

Stock Brokers

The third method of sale through brokerage houses, represents the means most commonly used by individuals for buying and selling stocks. Today brokers, like security dealers, are located in most of the larger cities. Brokerage houses, also, are open to the investing public, make available investment information, and have posted the current market quotations on stocks listed on the major exchanges. Brokerage houses generally have a right to trade on the major stock exchange -- that is, they have a seat on the New York Stock Exchange. As mentioned in section I of this chapter, a substantial portion of the stock transactions are consummated at this exchange. Transactions on the New York Stock Exchange and New York Curb together represent the great bulk of stock sales. Listed or registered on this exchange are stocks of most of the larger national corporations in which there is an active trade. The broker, like the security dealer, may also be a member of one or more of the smaller stock exchanges. While the security dealer tends to do most of business in unlisted stock and in that of smaller and local companies, the brokerage house tends to deal mainly in securities listed on the New York exchanges.

The broker occupies a different position from the security dealer in a stock transaction. An individual, desiring to buy or sell certain shares, informs the broker of his desires; the brokerage house then acts as this person's agent and makes a purchase or sale in the customer's behalf. In the case of stocks

listed on the New York Stock Exchange, the local office of the brokerage house communicates the customer's directions to the New York office and the New York office, also acting as the customer's agent, makes the requested transactions on the exchange. This means that broker never has title to the stock involved; title passes between the customer and the third party. If a sale is involved, the proceeds are credited to the customer's account, and he is subsequently paid unless he wishes to leave the money in his account to cover subsequent purchases. If a purchase is involved, the customer is billed for the total cost.

If the customer desires, the stock which he bought will be endorsed and transferred to him by the seller, and the transfer records of the corporation whose stock was traded will be changed to reflect the change in ownership. However, the great bulk of sales in which brokerage houses are involved are not completed in this way. Instead, the widely used and accepted practice of holding stock in "street name" is employed. This means that the stock is held in the name of the brokerage house and, by bookkeeping records and entries kept by the broker, the stock and the dividends received by the house are credited to the customer. Under the "street name" practice, then the customer would not receive the stock certificates after he bought the shares; the brokerage house would keep them for him at the main office in New York City. This means that no change need be made on the transfer records of the corporation if the transfer is, in effect, from one customer of the broker to another. The change in ownership and the right to dividends is reflected on the books of the broker. The "street name" practice is considered a service to the customer in that he need not take possession of the certificates and the broker collects dividends on his behalf. This practice is also convenient because shares actively traded do not require a number of changes on the transfer records to reflect each different owner of the stock.

Property Interests Subject to the Tax

In essence, the stock transfer tax is a tax on transfers of documents or memoranda representing a proprietary interest in "any domestic or foreign association, company, or corporation" and "in any business conducted by trustee or trustees." [37] Whether the property interest transferred represents "the beneficial interest" or "legal title," it is taxable. The property interests whose transfer is taxed are those represented by (1) "shares; or certificates of stock," (2) "certificates for rights to stock," (3) "certificates of deposit representing an interest in or representing certificates made taxable under this Section," or (4) "certificates of interest in any business conducted by trustee or trustees." The tax, then, is on the transfer of documents representing proprietary interests. It does not cover the transfer of all corporate securities. Evidences of indebtedness, such as bonds, are not property subject to be taxed upon their transfer. It is the function of this portion of the section to analyze the four property interests whose transfer is taxed.

[37] Acts 52d Leg., R.S. 1951, ch. 402, sec. XVII, pp. 716-717.

subscription warrant is not a right to stock within the meaning of the tax law;[41] but New York has held that a right to subscribe for stock after part payment of the subscription price is a taxable property interest;[42] that is, a right to stock after subscription, even though only part of price has been paid, is taxable.

Option warrants or stock purchase warrants give the holder the option to subscribe for or to buy shares of common stock at a stipulated price per share, usually within a limited time. The warrants may be separable from the securities with which they are issued. If they are detachable, they are frequently traded in on the stock exchanges.[43] They may represent a valuable right to buy stock that has been issued and is held by the corporation, such as treasury stock, for example, or stock to be issued. In the latter case, it would seem to be a subscription warrant. Option warrants are taxable by the states which tax "rights to subscribe for or to receive" stock, but apparently they are not property interests subject to the tax in Texas and states like New York, which have similar statutes.

It seems, then, that "certificates for rights to stock" means documents embodying rights to receive stock but not rights to buy stock. Only the transfer of the first kind of document is taxable in Texas. Several examples of documents representing rights to receive stock may help in understanding the coverage of the provision under discussion. A common example is voting trust certificates. They are issued under a variety of conditions. For example, a Corporation sells its business to B Corporation in return for a stipulated amount of the latter's common stock; the sales agreement directs that B Corporation deliver this voting stock to T, who will hold B's stock as trustee for A Corporation's stockholders. A's stockholders are issued voting trust certificates to replace the interest they had in A Corporation represented by A Corporation's shares they held. The voting trust certificates represent a valuable interest. A transfer of such certificates would seem to be a transfer of "certificates for rights to stock,"[44] as the voting trust agreement generally provides that after a stated time, the trust will terminate and the stock will be returned to holders of the voting trust certificates. The transfer of voting trust certificates from one holder to another has been declared the transfer of a taxable property interest by the Attorney General, but apparently on the ground that they are "certificates of deposit representing an interest in or representing certificates made taxable by this section" and that they are documents "investing the holder with the beneficial interest in . . . stock or other certificates taxable" by this law.[45]

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41 Stock Transfer Guide Service, Commerce Clearing House, par. 6012 A.01.

42 Sohmer v. Hebden, 216 N.Y. 728, 111 N.E. 1100 (1916). The Sohmer case is approved and adopted in Op. Tex. Atty. Gen. No. 0-5833 (April 7, 1944).

43 Ballantine on Corporations (rev. ed., 1946), pp. 514.

44 Christy and McLean, op. cit., pp. 539-540.

45 Op. Tex. Atty. Gen. No. 0-3765 (Sept. 4, 1941).

Shares or Certificates of Stock

The usual document representing a proprietary interest in a business entity is the stock certificate or share of stock. Technically, share and stock certificate may be distinguished. A share is a unit of interest in the corporation giving the owner an undivided interest in the corporation's property, the right to share in its profits, and, generally, a voice in its management. Stated another way, "a share of stock may be described as a profit-sharing contract, one of a series of units of interest and participation, authorized by the charter of a corporation, by which capital is obtained in consideration of a proportional right to participate in dividend and other distributions." [38] The certificate of stock, on the other hand, is the document representing one or more shares of stock. In common parlance, however, shares, shares of stock, stock, and certificates of stock are frequently used interchangeably.

The description, "shares; or certificates of stock," poses no real problem in determining property subject to the tax. It describes the usual form of the property whose transfer this tax is intended to reach. The remaining classifications are apparently included to tax interests treated so like shares in the business and which, in fact, may be considered as the same for tax purposes.

Certificates for Rights to Stock

The New York tax law, from which Texas appears to have borrowed its law, taxes "certificates of right to stock ;" while the federal, Florida, and South Carolina laws tax "rights to subscribe for or to receive" stock. [39] "Certificates for rights to stock," the Texas phraseology, seems directed at documents that do not represent the share of stock itself but represent a right to acquire shares or represent a property interest in shares or both.

Documents which represent the right to buy or receive shares of stock are bought and sold in the security market. The limits and conditions on these rights are numerous; hence no attempt will be made to explore all of them. Only a few of the more common instances will be examined. Among the documents which represent a right to buy shares are subscription warrants and option or stock purchase warrants. A literal reading of the quoted language of the statute would seem to indicate that any certificate giving the holder a right to buy stock is taxable property. However, the Attorney General has ruled that the transfer of a subscription warrant is not taxable. [40] New York has similarly construed its law on the grounds that a

38 Ballantine on Corporations (Rev. ed., 1946), p. 465.

39 Christy and McLean, Transfer of Stock (2d ed., 1940) pp. 533-537. For a good discussion of the numerous questions of tax coverage that arise under this phraseology, this reference work should be consulted.

40 Op. Tex. Atty. Gen. No. 0-5833 (April 7, 1944).

Another kind of certificate whose transfer would be taxed in Texas under the provision being discussed is a certificate which represents a right to get shares but which is not itself a share. For example, in a reorganization of the capital structure of a corporation, all or a certain class of the stockholders might be issued interim certificates to replace their stock certificates. These interim certificates do not give the holders full rights of shareholders but entitle them to receive them, after a stated time, when they receive stock certificates.

Since the stock transfer tax is on transfers of documents representing a proprietary interest in an enterprise, bonds, which are obligations, are not ordinarily taxed. However, certain corporate bonds may include provisions which raise questions whether their transfer is subject to the tax. A bond may provide that upon certain conditions and within certain time limits it may be exchanged for a stipulated quantity of stock. These bonds are commonly called convertible bonds. As such bonds grant a right to convert them into stock, they could be considered "certificates for rights to stock." One discussion declares that transfers of these bonds are not taxed as they do not embody rights to stock or to receive stock but only a right to convert, and these are said to be essentially distinct rights.[46] Occasionally, bonds may grant other rights to their holders that change their character from purely that of a debt to something resembling a proprietary interest. Whether such bonds would be taxable is not clear. For example, is a bond granting voting rights upon certain conditions a taxable interest after the occurrence of the conditions?

Certificates of Deposit Representing Taxable Interests

The Texas act taxes the transfer of "certificates of deposit representing an interest in or representing certificates made taxable under this law." The documentary interests subject to the tax under this provision are very similar to those taxed by the provisions -- "certificates for rights to stock" -- and in some cases a particular property interest would seem to fall within both provisions. For example, voting trust certificates would seem taxable under either or both provisions.

Certificates of deposit may be used in a number of circumstances. It will aid understanding of the coverage of this provision to set out one such instance. In a recapitalization plan, it may be desired to substitute Class A common stock for the 6-per-cent cumulative preferred. This might be done, for example, to eliminate the substantial arrearages on dividends due these preferred stockholders so that the corporation's common stock will be more attractive to investors.[47] During the completion of this plan, the preferred stockholders would deposit their shares with a trustee, who would represent

46 Christy and McLean, op. cit., p. 537.

47 Ballantine on Corporations, op. cit., pp. 693-697.

their interests, and in the meantime would be issued certificates of deposit covering the shares turned in and those to be received. When the plan is completed, the holder of such a certificate turns it in and receives his shares of Class A common. From the time the recapitalization plan is begun until it is completed, trade may be carried on in the certificates of deposit. Their sale is subject to the tax.[48]

Certificates of Interest in Business Conducted by Trustee

Texas, along with New York, taxes transfers of "certificates of interest in any business conducted by trustee or trustees." The language indicates documents representing an interest in any commercial endeavor, whether a corporation or not, is subject to the tax if the business is conducted by a person holding legal title to the property of the business in behalf of the holders of such documents or certificates. In New York, this language has been declared to include certificates of a joint-stock association and certificates of participation in a syndicate.[49]

An opinion of the Attorney General indicates that the coverage of this provision was not intended to be as broad as a quick reading of it would seem to indicate.[50] The question was put whether the transfer of certificates issued by T, a trustee, representing rights to the working interest in oil and gas leases was subject to the stock transfer tax. A, B, C, and T had owned this working interest; they transferred legal ownership of it to T, who was to hold it in behalf of all of them, and T issued certificates to all four. The test to be employed was to determine whether the arrangement amounted to a "business trust," as the tax law requires that the business be conducted by "trustee or trustees." A central question, according to the opinion, is whether the trustee has real management powers, such as the power to buy and sell lease interests, and whether he is subject to some control by the holders of the certificates, such as being selected by them. This requires an examination of the trust indenture setting up the arrangement to determine whether the circumstances are such that the "certificates of interest" generally approximate certificates of stock in their rights and obligations and whether the enterprise in which such certificates represent an interest is substantially like a corporation. Certificates of interest in so-called "Massachusetts Trusts," then, would be taxable.

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48 For a treatment of a number of circumstances in which this provision comes into play, see Christy and McLean, *op. cit.*, pp. 537-539.

49 Christy and McLean, *op. cit.*, p. 543, citing (1912) Op. of Atty. Gen. (N.Y.) 525, and (1911) Op. of Atty. Gen. (N.Y.) 692.

50 Op. Tex. Atty. Gen. No. 0-4035 (October 27, 1941).

Certificate of Interest in Other Than Corporations

The tax apparently was designed primarily to tax the transfer of certificates of shares in corporations. However, documents representing a proprietary interest "in any association, company, or corporation" are taxable. Discussion of the provision mentioned in the preceding section demonstrates that the reach of the tax law is beyond mere ordinary corporate stocks. It would seem that any certificate representing a participating or proprietary interest in "any association or company" is taxable property. The express exclusion of shares, share accounts, certificates, or pass books issued by building and loan associations chartered in Texas and by credit unions removes any doubt as to their coverage.[51] But what of certificates of interest issued by membership associations, co-operatives, limited partnerships, and the like?

Transfers Subject to the Tax

In order for a stock transfer to be subject to the tax, it must not only concern a taxable interest but the transfer itself must be of the kind made taxable by the act. In the previous section, what constitutes a taxable interest or taxable property has been explored. In this section, the character the stock transfer must have to be taxable will be examined. As previously mentioned, a stock transfer otherwise taxable is not subject to the Texas tax unless it has a contact with Texas. The question of the connection a transaction must have with Texas to be within the reach of the Texas tax law will be taken up separately in a following subdivision of this section.

Transactions subject to the tax are (1) "all sales; (2) agreements to sell; (3) or memoranda of sales; (4) and all deliveries or transfers of" documents representing taxable property interests, "whether investing the holder. . . with the possession or use thereof (of the certificate) for any purpose, or to secure the future payment of money or the future transfer of any such stock, or certificate." This provision is further amplified by the provision that such transfers are taxable "whether made upon or shown by the books of the association, company, corporation, or trustee, or by any assignment in blank, or by any delivery of any papers or agreement or memorandum or other evidence of sale or transfer or order for or agreement to buy, whether intermediate or final, and whether investing the holder with the beneficial interest in or legal title to" a taxable documentary property interest.

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[51] Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 10.

An examination of these provisions of the statute indicates that practically every kind of transfer and every aspect of a stock transaction is included in the tax's coverage. The express exemptions which reduce the coverage of the tax will be discussed subsequently. It would not be appropriate or practicable to specify all of the different kinds of transfers subject to the tax; however, an examination of some of the more common transfers under the different categories set up by the statute may aid in understanding the tax. In the following discussion, it should be kept in mind that a stock transaction from its initiation to its completion may involve several of the aspects of a transfer which is made taxable. Of course, a single transaction is taxed only once. As will be better understood after reading a subsequent portion of this section, one of the reasons the tax law splinters a stock transaction into a number of different aspects or steps is so that the transaction can be reached by the Texas tax if one such aspect has the necessary connection with Texas, even though the entire transaction did not take place in this state.

Sales

The sale of stock is the transaction which the stock transfer tax is primarily designed to tax. It is the usual situation. It is the usual situation. It is the completed transaction which normally includes the delivery of the certificates to the buyer and the payment of the price by the seller. The remaining categories of transfers subject to the tax are those which either are tantamount to a sale, will develop into a sale, or are one aspect of a complete sales transaction.

Agreements to Sell

An agreement to sell is distinguished from a sale in that it is an executory contract, while a sale is an executed contract. An agreement to sell is an agreement to make a completed sale at some future time under specified conditions. For example, A and B agree that A will sell to B and B will buy from A 10 shares of A Corporation common stock at $100 a share, delivery of shares and payment of price to take place 15 days after the date of the agreement. This is a taxable transfer; but, of course, the transaction will not be taxed again when the agreement is carried out.

The federal act also taxes "agreements to sell." Regulations have construed this to include contracts to sell, written or oral, including those on deferred or partial payment plan, and options, calls, offers, indemnities and privileges.[52] A clearer understanding of the operation of the tax may be obtained by examining the taxability of a form of option contract--"puts and calls." A "put" is a contract by which the maker agrees to buy from the holder of the "put" a specified number of shares of designated stock at a certain

[52] Christy and McLean, Transfer of Stock (2d ed., 1950 Supp.) sec. 340, pp. 124-125.

price at any time within a specified period. A "call" is a contract by which the maker agrees to sell to the holder of the "call" a specified number of shares of designated stock at a certain price at any time within a specified period. As these are option contracts, the holder of an instrument embodying the "put" or "call" is under no obligation to exercise the right given him; but, of course, both types of option agreements could mature into a sale of stock.[53] Does the making of either of these agreements constitute a taxable transfer under the "agreements to sell" clause of the tax law? The New York act has been construed as taxing "calls" as agreements to sell but not taxing "puts," since they are not agreements to sell but agreements to purchase.[54] Apparently, this question has not been ruled upon in Texas. However, it has been ruled that an ordinary agreement to sell cannot be split into its two parts--a promise to sell and a promise to buy--so that if only the promise to buy is made in Texas the tax is avoided. It was ruled that such an agreement should be considered in its entirety and that it is subject to the tax as an agreement to sell.[55]

Memoranda of Sales

"Memoranda of sales" seems to contemplate an instrument containing a simple statement of the names of the seller and buyer of stock, date of the sale, description of the stock, the price, and any other pertinent information. In making this transfer taxable, the statute would seem to be covering a great number of situations. The preparation of a bill or memorandum of sale would ordinarily seem to be but one step in a stock sales transaction.

One commentary states that the real purpose of a memorandum of sale is to serve as the instrument to which the tax stamps are affixed in the exchange of stock endorsed in blank. Stock so endorsed may be sold and transferred without further endorsement by simple delivery of the certificates. If there is no memorandum of sale in this case, there is no instrument of transfer to which stamps may be attached. The memorandum, then, surmounts this troublesome detail.

When a customer deals with the local office of a New York brokerage house, the office may mail the customer a memorandum setting out the fact that the purchase or sale requested has been accomplished and the details of it. Are these communications "memoranda of sales"? Although a

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[53] John H. Prime, Investment Analysis (Prentice-Hall, 1946), pp. 94-97.

[54] Christy and McLean, Transfer of Stock (2d ed., 1940), pp. 526-527, and 1950 supp., pp. 125.

[55] Op. Tex. Atty. Gen. No. 0-3594 (Aug 6, 1941).

literal reading might indicate that they are, the Attorney General has ruled that they are not and hence do not constitute taxable transfers, since the law was not intended to tax "mere copies of memoranda ancillary to" the sales transaction.[56]

Deliveries or Transfers

The fourth category of taxable transfers is "all deliveries or transfers of" stock or other documents taxed by the act. The two words--"deliveries" and "transfers"--are neither identical nor distinctly different in meaning. "Deliveries" would seem to be directed primarily at physical exchanges of stock certificates, while "transfers" seems principally directed at the conceptual events of change in ownership--that is, passage of title to the shares. An examination of some of the transactions or portions of transactions covered by this provision and which may not be included under any of the three previously discussed categories may assist a further understanding of this class of taxable transfers.

A gift of stock would not be covered by any of the preceding classes of taxable transfers because they all relate to sales. However, it seems quite clearly to be taxable as a delivery or transfer. Although Texas has no gift tax, it does have an inheritance tax which levies a tax on the beneficiary or heir for the gifts he receives from the decedent. It seems that a testamentary gift of stock or other taxable document would be taxed under both the stock transfer tax and the inheritance tax; and such is administrative practice. It has been ruled that no tax is due on a transfer of stock from a decedent to his executor or administrator, but the transfer from the estate to the legatee or heir is taxable.[57]

The delivery of possession or the transfer of title to stock by a borrower to his lender as security for the loan would seem taxable under "deliveries or transfers"; however, the act expressly exempts this transaction from the tax. But a question may arise whether somewhat similar transactions are also exempt. The Legislature recently adopted the Motor Vehicle Safety Responsibility Law, and section 25 of that act provides that a person required to give proof of financial responsibility may make such proof by depositing securities having a market value of $15,000 with the State Treasurer.[58] This deposit is held to satisfy claims arising out of accidents against the person making the deposit. Although proof of responsibility will probably be most frequently made through insurance, the deposit of securities will probably occur. Is the deposit a "delivery or transfer" within the meaning of the tax act so that the transaction requires payment of a stock transfer tax? The transaction does not seem to fall clearly within any of the express exemptions, and no rulings in Texas or other states have been

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[56] Op. Tex. Atty. Gen. No. 0-3594 (Aug. 6, 1941).

[57] Op. Tex. Atty. Gen. No. 0-3520(May 23, 1941); Op. Tex. Atty. Gen. No. 0-4134 (Sept. 4, 1942).

[58] Acts 52d Leg., R.S. 1951, ch. 498, sec. 25, p. 1222.

found treating the question. The deposit of securities with a bank by a foreign insurance company in compliance with state laws to assure the company's ability to meet its policy obligations has been ruled taxable as a "delivery" under the federal law.[59] It has been held, however, that the New York law requires something more than a mere change of physical possession to incur the tax.[60] The Texas Attorney General has ruled that a transfer to a custodian is not a taxable transfer, since it does not involve a change in title or ownership. The opinion stressed the provision, "whether investing the holder with the beneficial interest in or legal title to" and did not use the provision, "whether investing the holder...with the possession or use thereof for any purpose," in solving the problem.[61] If the Treasurer is considered a custodian in such cases--and it is not clear whether he is--then it would seem that this deposit of securities is not taxable under the stock transfer tax.

A transfer of the stock of a company made upon its stock transfer records is taxable under the act.[62]

In this survey of transfers subject to the tax, an attempt has been made to indicate some of the major categories of transactions which are taxable. This discussion is not intended to be complete nor authoritative.

Exemptions of Property and Transfers

Transactions involving certain kinds of documentary property interests and certain kinds of transfers are expressly exempted from the tax. A stock transfer tax is not due on the following transactions:

(1) "an agreement evidencing the deposit of certificates as collateral security for money loaned thereon, which certificates are not actually sold,

(2) nor upon such certificates so deposited,

(3) nor upon transfers of such certificates to the lender or to a nominee of the lender or from one nominee of the lender to another, provided the same continue to be held by such lender or nominee or nominees as collateral security as aforsaid,

(4) nor upon the retransfer of such certificates to the borrower;

(5) nor upon transfers of certificates from a fiduciary to a nominee of such fiduciary, or from one nominee of such fiduciary to another, provided the same continue to be held by such nominee or nominees for the same purpose for which they would be held if retained by such fiduciary,

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59 Christy and McLean, Transfer of Stock (2d ed., 1940), p. 529.

60 Ibid, pp. 532-533.

61 Op. Tex. Atty. Gen. No. V-648 (August 5, 1948).

62 Op. Tex. Atty. Gen. No. 0-3713 (July 29, 1941).

(6) or from the nominee to such fiduciary;

(7) nor upon mere loans of stock or certificates, or the return thereof;

(8) nor upon deliveries or transfers to a broker for sale;

(9) nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased the same, ...

(10) nor upon transfers or deliveries made pursuant to an order of the Federal Securities and Exchange Commission which specifies and itemizes the securities ordered by it to be delivered or transferred...;

(11) nor upon record transfers following such transfers or deliveries."

Transactions involving shares, share accounts, certificates, or pass books issued by a building and loan association chartered in Texas and credit unions, as defined by Texas law, are also expressly exempt from the tax.[63]

The eleven transactions exempted by the above language may be grouped as follows: (1) changes of possession or ownership of stock resulting from its being pledged as security for loans, (2) transactions involving fiduciaries, (3) mere loans, (4) transfers involving broker and customer, (5) and forced transfers resulting from Securities and Exchange orders under the Public Utility Holding Company Act.[64] These specific transfers exempted seem to be ones not involving an ordinary sale.

Original Issue

The question has arisen whether the corporation's delivery of its stock to a subscriber is taxable. Although a literal reading of the law might indicate that it is, the Attorney General has ruled that the original issue of stock is not a taxable transfer.[65] The stock transfer tax laws of New York, Massachusetts, and Pennsylvania have been similarly construed.[66] The issue of stock by a corporation is essentially different from the sale of the corporation's stock by one person to another. The corporation is not a seller, in an ordinary sense, in such case. It was said that the intent of the act is to tax the person selling the corporation's stock and not the corporation whose stock is transferred; this intent would be violated if the original issue were taxed. Although a tax is not levied when stock is reissued in the same amount to the same persons who previously held the stock, a tax is due when shares are called in for cancellation, held by the company as treasury stock, and subsequently reissued or sold by it.[67]

63 Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 10.

64 In 1946, the Attorney General ruled that a forced transfer resulting from such an order was taxable. Op. Tex. Atty. Gen. No. 0-7059 (March 13, 1946). The provision expressly exempting such transfers was added by the Legislature in 1947.

65 Op. Tex. Atty. Gen. No. 0-3594 (Aug. 6, 1941).

66 Christy and McLean, op. cit., pp. 550-551.

67 Op. Tex. Atty. Gen. No. 0-4134 (September 4, 1942).

Stock Transaction's Contact with Texas

For a stock transaction to be liable for the tax in Texas, it must not only involve a taxable documentary property interest and be the kind of transfer made taxable but also must have a connection or contact with Texas soil. The question of what transactions, so far as their geographical location is concerned, are within the reach of a particular state tax is a question of the power of the state to tax and of which of the transactions within its power or jurisdiction to reach it has in fact taxed. The first question is one of constitutional and general international private law; the second is one of construing the construction of provisions of the particular tax statute. It is generally accepted that a state has the power only to prescribe rights and obligations with respect to acts occurring within its borders; that is, a state cannot enact laws having an extra-territorial effect.[68]

The stock transfer tax act provides that "if neither the sale, nor the order for, nor agreement to buy, nor the agreement to sell,, nor the memorandum of sale, nor the delivery is made in this State and when no act necessary to effect the sale or transfer is done in this State," the tax is not assessed. Examination of this provision indicates that the act appears substantially to have exhausted the full jurisdiction of Texas to levy the tax. The act has been interpreted to impose a tax if any of the following occur in Texas: an executory or executed contract of sale, whether oral or evidenced by a writing; a delivery of shares or stock certificates; and a transfer of shares upon the official books and records of the corporation whose stock has been exchanged.[69] A given stock transaction is taxed only once. If one of the above-enumerated events occurs in Texas, a transfer tax is imposed; whether any or all the rest of the steps in the transaction occur in Texas does not affect the amount of tax due.

In the application of the stock transfer tax, little difficulty is encountered in understanding what the statute prescribes as acts which must occur in Texas before a tax is due. The more troublesome questions involve determining whether a particular act took place in Texas. In short, the more difficult question is one of legal fact. An examination of some of the more common stock transactions or steps in such transfers may furnish a fuller appreciation of this legal fact problem.

Sales Contracts

If either an executed or executory sale is made in Texas, a tax is due on the stock sold. The place where either kind of contract occurs is governed by the same rule; the question is the place of making. In general, a contract is made where the last event necessary to create a binding agreement occurs.[70]

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[68] Stumberg, Conflict of Laws (2d ed., 1951), pp. 54-68.

[69] Op. Tex. Atty. Gen. No. 0-3713 (July 29, 1941).

[70] Stumberg, op. cit., pp. 224-232.

In the ordinary situation, this event is the acceptance of the offer.[71] In the usual situation, then, if the acceptance of the offer is made in Texas, the sale or agreement to sell stock is taxed.

The fact question to be determined is narrowed, then, in the ordinary case, to determining where acceptance was made. Where A and B deal face-to-face in Dallas and make a contract for the sale of stock, it is obvious that the acceptance was made in Texas and that the transaction is taxable. But the problem becomes less easy when A in Dallas deals by telephone, telegraph, or mail with B in New York City. Suppose A says to B, "I offer to sell you 5 shares of X Corporation stock for $100 per share," and B replies, "I accept your offer." As B made his acceptance in New York City, the contract was made there and is not taxable by Texas. If, instead, B had replied, "Your price is too high; I'll give you $95," and A had then replied, "O.K.," the contract would have been made in Texas, since A was accepting B's counter-offer, and he did that in Dallas.

It should be remembered that a person may not only conduct the negotiation leading to a stock sales contract himself but may also use an agent to act in his behalf. In the latter case, the contract is made where the agent accepts the offer. As explained early in this section, stock borkers customarily act as agents for their customers. In view of practices in the securities market, this means that most of the sales and agreements to sell are made in New York City by brokers trading on the New York exchanges and acting as agents in the sale and purchase of stock in behalf of their customers.

Where security dealers act in their own behalf, the same factors mentioned above in the discussion of sales between individuals are applicable.

These considerations mean that, as a practical matter, little of the business conducted by brokerage houses for Texas customers is subject to the Texas tax, while much more of the business conducted by Texas security dealers is subject to the tax.

Deliveries

As previously mentioned, a transfer is taxable if a delivery of stock takes palce in Texas. Thus, although the contract for the transfer is not made in Texas, the transfer may nevertheless be taxed because the delivery takes place in the state. Delivery has been defined in the law of sales to consist of "giving real possession of the thing sold to the vendee or his servant or special agent," and the "transfer of the possession of personal property from one person to another."[72] The problem is to determine where the delivery took place in a given stock transaction.

[71] American Law Institute, Restatement of the Law, "Contracts," secs. 1, 22, and 52.

[72] Black's Law Dictionary (3d ed., 1933), pp. 548-549.

Where the entire transaction, including the handing over of the stock personally or by mail or messenger, takes place in Texas, no problem is presented. As in the case of sales contracts, the troublesome questions arise in multi-state transactions. If, in accordance with directions of the purchaser, the seller ships the stock certificates to the buyer by mail or common carrier, delivery occurs when the seller presents the certificates to the carrier or post office for shipment.[73] If that act occurs in Texas, there is a delivery in Texas and a tax is due on the transaction, regardless of where the rest of the steps took place.

As in the making of contracts for the sale of stock, a person can accomplish the delivery of stock certificates by utilizing an agent to act in his behalf. The stock brokerage house is a most popular agent. When it is remembered that the great bulk of the stock in which brokers deal is held in "street name" and that most transactions involving brokers are consummated in New York City, it can be seen that most transactions carried out by brokers in behalf of Texas residents involve deliveries made in New York instead of Texas and so are not taxable. The broker not only makes the contract on the floor of the exchange in the customer's behalf, but he also accepts and makes the deliveries of the stock there in the customer's behalf.

Again, the security dealer doing business in Texas, when acting in his own behalf, is in the same position as an individual. This means that some of his transactions will involve deliveries in Texas and so can be taxed. However, few transactions conducted by the brokerage houses will include deliveries in the state.

Transfers

Although the sale and delivery of stock is completed out of the state, the transaction may still be taxed if a "transfer" occurs in Texas. "Transfers" probably includes both transfers of title to the shares and transfers on the stock transfer records of the corporation whose stock has been exchanged.[74] Transfers of title include those resulting from both sales and gifts. The question is one of ascertaining when title passed and where the property was at that time. A general rule for sales of personal property is that title is presumed to pass when the unconditional contract is made for the sale of specific goods.[75] If such a contract for the sale of stock were made, title would pass at the place where the stock was situated at the time the agreement was made; and it would seem that if the stock were situated in Texas in such a case, a tax would be incurred even though the remainder of the transaction took place elsewhere.

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[73] Vold, Law of Sales (1931), p. 419.

[74] Christy and McLean, op. cit., p. 530.

[75] Uniform Sales Act, sec. 19, rule 1; 2 Williston on Sales (rev. ed., 1948) p. 12 et seq.

As a practical matter, however, the "transfer" clause has its major use where a transaction involves stock whose transfer is recorded on the corporation's books which are situated in Texas. In the operation of this clause of the tax law, three questions are presented: (1) What records are considered in determining whether a transfer upon the stock records of a corporation has occurred in Texas? (2) What corporations must keep this kind of record in Texas? (3) As a matter of practice, when are stock transfers recorded on the books of the corporation?

The answer to the first question as given by the Attorney General is that only transfers recorded in Texas on the "official records" of the corporation are taxable.[76] The Attorney General also has ruled that corporations chartered by Texas, and not foreign corporations, were required to keep their official transfer records in Texas.[77] A domestic corporation may maintain a transfer agent in another state, near an important security market like New York City, for example, but it must maintain in Texas its official stock records on which all requested transfers are made. In effect, only transfers made on the stock record books of corporations chartered in Texas are taxed under this provision.

The next question that quite naturally arises is whether every sale or gift of shares in a Texas corporation results in a transfer being recorded on the company's books so that a stock transfer tax becomes due. The simple answer is no. The explanation lies in the prevalent practice of holding stock in "street name," the mechanics of which were explained at the beginning of this section. A national brokerage firm operating in Texas estimates that about 90 per cent of the stock transactions it conducts involve "street name" transfers; whether the percentage is as high for stock of Texas corporations traded on the two New York markets is not known.

A purchaser of shares need not have the change of ownership recorded on the stock transfer records of the corporation; and where stock is held in "street name" or is assigned in blank, no record of change in ownership is made on the corporation's books. Failure to register the transfer means that, as against the corporation, the owner is not entitled to all the rights he would otherwise have. The corporation is entitled to treat the registered owner as the one *prima facie* entitled to dividends and to voting rights.[78] The tendency

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76 Op. Tex. Atty. Gen. No. 0-3713 (July 29, 1941).

77 Op. Tex. Atty. Gen. No. 0-3713A (December 2, 1942). This conclusion was reached through an interpretation of Tex. Civ. Stat. (Vernon, 1948) arts. 1328 and 1358. The privision of Texas Const. art. X, sec. 3, stating that "every railroad or other corporation, organized or doing business" in Texas shall keep stock record book in a public office established by it in Texas, was construed as applicable only to railroads and corporations in a similar business. The records required of foreign corporations by this provision of the constitution were declared not "official records" for purposes of the stock transfer tax but reflections of the transfers recorded on the original records kept in the state of incorporation.

78 *Ballantine on Corporations* (rev. ed., 1946) pp. 753-756; Tex. Civ. Stat. (Vernon, 1948) art. 1358-3.

is for persons holding stocks for investment to have the transfer registered on the corporation's records and for those holding stocks for shorter periods and for speculation to hold in "street name."[79]

It can be seen, then, that not all transactions involving the stock of Texas corporations will result in registration of a transfer on the official stock records of the company in Texas. Thus, the state does not collect a stock transfer tax every time the stock of a Texas corporation is transferred. Although many of the transfers of Texas corporations' stocks not resulting in a change in registration are the result of the brokerage house practice of holding stock in "street name," some of the transfers which thus avoid tax liability result from exchange of stock endorsed in blank. The latter transfers may involve security dealers and individual traders.

In summary, a stock transaction involving a taxable documentary property interest and the kind of transfer taxed by the law will be subject to the Texas tax if the sale, agreement to sell, delivery, or transfer occurs in Texas. If one or all the steps in a complete transaction transpire in Texas, the stock transfer tax is due, and the amount of tax will be the same, no matter how much of the transaction took place in the state.

Computation of the Tax

For stock transactions which involve stock having par value, the tax is assessed at 3.3 cents per $100 of par value or fraction thereof. In computing the tax, the number of shares is disregarded; only the total par value of the shares transferred is taken into account. For example, the sales of 15 shares having par value of $10 each and of three shares having a par value of $50 each would both be taxed the same amount--6.6 cents.

If a stock transaction involves no-par stock--stock without designated value, the tax is assessed at the rate of 3.3 cents per share. The selling price is disregarded in computing the tax. This is true whether the sale involves stock having par value or no designated value.

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[79] The mechanics of having a transfer registered or recorded involve the holder's giving sufficient evidence of ownership to the corporation, the surrender of his certificate, and the issue of a new certificate to him. The larger corporations have transfer agents, frequently located near the larger exchanges, who attend to such matters. Registration of a transfer may take a week or more, especially if the books are closed for payment of dividends. For a description of security market operations, see John H. Prime, Investment Analysis (New York: Prentice-Hall, Inc., 1950), pp. 77-106.

Who Pays the Tax?

The preceding discussion has been concerned primarily with the question of when the tax is assessed. Attention should now be given to who pays the tax. The statute provides, "It shall be the duty of the person or persons making or effectuating the sale or transfer to procure, affix, and cancel the stamps and pay the tax provided in this Article." The statute is explicit that the seller is expected to pay the tax.

Evidence indicates that in most taxable stock transactions between individuals, the seller in fact does pay the transfer tax. It is also understood that in taxable stock transfers effected through over-the-counter dealers or investment bankers, the tax is paid by the seller, regardless of whether the dealer or the customer makes the sale.

However, the Texas stock transfer tax is always paid by the purchaser rather than the seller in transactions executed through brokerage houses. This is a direct result of the business operational procedure employed by brokers. As indicated in the preceding sub-sections, transactions made through brokers are taxable only if a transfer occurs on the stock record books of a corporation chartered in Texas. Whether the transfer is made on the corporation's records and the tax is thereby incurred depends primarily on the desire of the purchaser. If he wishes the broker to hold the stock for him in a "street name," there is often no need for the transfer to be recorded and no tax is assessed. However, if the purchaser wishes the transfer to be recorded in his name, the tax will be assessed. Because the purchases and sales made by brokers on the exchange among themselves do not result in simultaneous deliveries of the stock sold but are "cleared," something like a bank clearing, at the end of the trading day, and because of the "street name" practice, it cannot be determined who was the seller of the stock on which a Texas tax is due. Whether the tax is assessed on trading of stock held in "street name" or assigned in blank depends on whether the purchaser wants the transfer registered; and so it is the practice of most brokerage houses to pass the tax to the purchaser if the transfer is to be recorded and the tax assessed.

Summary

The assessment of the stock transfer tax has required an extended discussion. This was necessary because the tax operates in a business environment that is not within the common experience of all and because the tax is assessed in a variety of circumstances. The foregoing discussion seems to demonstrate that a number of factors must be taken into account before it can be determined whether a security transaction is subject to the stock transfer tax. The stock sale must (a) involve a documentary property interest or right which is taxed by the law, (b) be the kind of transfer which

the act makes taxable, and (c) have the necessary connection or contact with Texas to be taxed. In addition, it must not be expressly exempt by the statute. An examination of some of the details discussed in this section would seem to indicate that the tax administrator is faced with many troublesome questions in determining whether a transaction is taxable and in locating all taxable transfers. Applicability of the stock transfer tax has had no judicial development in Texas and only a partial administrative development. Thus there would seem to be a number of unanswered questions to puzzle the taxpayer and the tax administrator. To assist the taxpayer, the Comptroller has prepared a one-page mimeographed set of general instructions regarding application and computation. These are mailed to taxpayers upon request.

SECTION 4 - COLLECTION AND ENFORCEMENT

Method of Payment

The statute prescribes that payment of the stock transfer tax will be made through the purchase of adhesive stamps and will be denoted by affixing and canceling such stamps. Although alternate methods of noting the payment are acceptable under specified conditions, in all cases the stamps are to be initialed, dated, and perforated by the persons affixing them.[80]

Because, as pointed out in section 3 of this chapter, a stock transfer is taxed even though only a portion of the entire transaction takes place in Texas, it was necessary that the statute provide more than one way in which manifestation of payment by affixing stamps may be made. The law provides four methods for evidencing payment of the tax.

(1) Where the only Texas evidence of the transaction is a transfer upon the books of the corporation whose stock was exchanged, the person making the sale must provide the corporation with the stamps and the corporation must affix the stamps to the record book and cancel them.

(2) Where the transfer is effected by the delivery or transfer of the certificate, the stamps must be attached to the surrendered certificates and canceled.

(3) Where the step in the transaction which has a connection with Texas is the agreement to sell, a memorandum of the agreement must be made and the stamps attached to the memorandum. If the seller wishes, he may prepare this memorandum in duplicate, affix the stamp to the duplicate, retain the duplicate as evidence of his payment of the tax, and deliver the original to the buyer, the original noting that a duplicate was made and retained by seller and that the stamps are attached to it.

(4) Where a sale is effected by the delivery of a certificate endorsed in blank, the seller must prepare a memorandum of sale and affix the stamps as prescribed for agreements to sell.[81]

Preparation and Sale of Stamps

Responsibility for preparing stamps in such form, denomination, and quantity as deemed necessary is delegated to the Comptroller.[82] Although apparently the design on the face of the stamps has never been altered, the denominations offered for sale were increased after the

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[80] Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 4.

[81] Acts 52d Leg., R.S. 1951, ch. 402, sec. XVII, p. 716-717; Tex. Civ. Stat. (Vernon, 1948) art. 7047m, secs. 1 and 6.

[82] Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 2.

additional rate of ten per cent was enacted in 1950, and presently stamps are sold in denominations of .3, .5, 1, 3, 15, 30 and 75 cents and $1.50, $3, and $30.

As previously mentioned, it is the obligation of the seller to see that the transfer tax is paid and the stamps affixed to the proper document and canceled. The taxpayer may buy the tax stamps from either the Comptroller or county clerks, who are agents of the Comptroller for selling stock transfer tax stamps. Of the total stamps sales made during 1950, the Comptroller's Office sold approximately 75 per cent, with over 50 per cent of total sales being made to out-of-state brokers, bankers, and corporations. Sales by the Comptroller's Office are made largely as the result of requests for stamps received by mail. Although there is no clear trend, indications during the last few years are that stamp purchases from the Comptroller are heaviest during the first several months of the calendar year.

Stamp Sales by County Clerks

During the calendar year 1950, about 25 per cent of the total revenue from the stock transfer tax was accounted for by stamp sales made by county clerks. The tax law designates county clerks as agents of the Comptroller in making local sales of the tax stamps. Under the rule-making power granted, the Comptroller has prescribed methods for handling such sales. The county clerk requests the Comptroller to ship him a certain number of stamps. The Comptroller then ships the requisitioned stamps to the clerk on consignment, paying the cost of mailing or shipment. As the county clerk is the Comptroller's agent, he does not pay for the stamps when he gets them. A county clerk in one of the more densely populated counties, however, has in recent years been buying the stamps from the Comptroller instead of getting them on consignment. The reason for this practice is not known.

There appear to be no established policies or guide lines concerning when or how frequently stamps should be ordered or how large an inventory of stamps the county clerk should carry. As a result, orders for stamps are received whenever the clerks feel they need more stamps, and the quantity ordered seems dependent upon the individual judgment of the clerk. Some county clerks maintain a balance of $300 in stamps, while others keep as much as $13,000 worth on hand. In general, county clerks having a substantial volume of sales keep a supply adequate for from three to six months. Clerks in some of the counties with smaller sales volumes keep a three-to-ten-year supply of stamps on hand.

The county clerk makes sales to taxpayers from the stamps he has on consignment. He must account for and pay over to the Comptroller the proceeds of the sales; the clerks and counties get no fee for making these stamp sales. Established procedure directs that the clerks make monthly reports to the Comptroller, setting forth the number of stamps sold during the preceding month by denominations, total stamp sales, and number of stamps on hand at the end of the month. At one time, the Comptroller required clerks to list persons to whom sales were made, but part of the report has been eliminated recently. Except in a few instances, the county clerks have been co-operative in forwarding the required reports on stamp sales.

Practice indicates that there is no firm requirement as to when and how often clerks should forward the moneys received. Most clerks send the proceeds of their sales monthly with their reports. One county clerk, however, apparently used to wait until he had what he considered a sufficient amount on hand, usually one to three thousand dollars, and then send in the proceeds. However, all now send in the proceeds of their sales monthly.

Although the law may have envisioned that every county clerk in the state would participate in the sale of tax stamps, it has developed that only a small number of them are involved. During the last several years, only 12 to 18 of the 254 county clerks have participated in the administration of this tax to any extent. These clerks, located generally in the more populous and commercial counties of the state, have accounted for 20 to 25 per cent of the stamp sales during the last few years.

Enforcement

Perhaps because of the nature of the tax and the business environment in which it operates, the law does not require the taxpayer to make any reports to the tax administrator. For its enforcement, the law relies upon maintenance of certain records by taxpayers and the audit of those records by the tax administrator--the Comptroller.

The act places the duty upon certain persons and firms to keep records prescribed by the law. All firms engaged in the brokerage business in Texas are to keep in some accessible place in Texas a transfer ledger which must include specific information, including the title and number of shares transferred, the date of each sale, the face value of the shares transferred, and the value of stamps affixed.[82] In addition, a stamp book is to be maintained wherein will be recorded each purchase of stock transfer stamps. A stock certificate book and a transfer ledger are to be kept by every corporation, and such transfer ledgers are to include information

82 Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 2.

concerning the date of each transfer, the serial number and transferor of each surrendered certificate, the serial number of the certificate in exchange thereof, and the value of the stamps attached. The corporations also are to retain all surrendered certificates and all memoranda relating to the transfer of shares.[83]

If the transfer is evidenced by a duplicate memorandum of sale, the seller must keep the duplicate stamped copy as evidence of payment and record the number which he gave to the sale of the original copy.[84] The identification number is to be entered also on a book of account, and indications are that the book of account to which reference is made is to be maintained by the corporation issuing the shares. All records and ledgers are to be maintained for at least two years and be open for inspection by the Comptroller or his appointed representatives during certain hours of each working day.

The scheme of the tax law apparently envisions that certain records would be kept by designated classes of taxpayers and that those records would be periodically audited or "spot checked" by the tax administrator. This, it was probably felt, would assure that almost all who incurred a stock transfer tax would pay it. Available information indicates that the only audits or field investigations that have ever been made in the administration of this tax were of county clerks' records in several of the larger counties and with regard to revenue from testamentary gifts where both stock transfer tax and inheritance tax were applicable. Apparently no audit or inspection of the required records of a broker, for example, has ever been made. It is not known how many of the persons required to keep stamp tax records by the law do so at the present time. Presently, one member of the tax administrator's staff devotes about one hour a day to answering mail requests for stamps, keeping office records, and taking monthly stamp inventories. The lack of a more energetic enforcement of this tax, then, may be the result of insufficient personnel being made available for the task.

Penalties

When the Comptroller learns that a person has failed to pay the tax, or otherwise violated the act, he is to initiate action through the Attorney General in the name of the State of Texas to recover the tax and to impose the penalty involved.[85] The penalty may result from one of four general

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[83] Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 6.

[84] Acts 52d Leg., R.S. 1951, ch. 402, sec. XVII, pp. 716-717.

[85] Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 6.

types of violations specified in the act. First, any person liable for the tax and failing to pay it and anyone acting as a broker or transfer agent for such a person is guilty of a misdemeanor. Penalty, upon conviction, may be a fine of not less than $500 nor more than $1,000 or imprisonment for not more than six months, or both.[86] Second, a failure to cancel the stamps properly is punishable upon conviction by a fine of not less than $200 nor more than $500 or imprisonment of not less than six months.[87] Third, a person who removes stamps for re-use or prepares, buys, sells, or possesses counterfeit stamps may be punished upon conviction by a fine of not less than $500 nor more than $1,000 or by imprisonment for not more than one year or both.[88] Fourth, every person, security dealer, or broker who fails to keep the required records or refuses to permit audits or a corporation that fails to keep its transfer records may be punished on conviction by a fine of not less than $500 nor more than $5,000 or by imprisonment for not less than three months nor more than one year, or both.[89] Most of the acts made violations of the law by the four sections just discussed are again enumerated in section 8 of the law; and it is provided that, in addition to the above-mentioned penalties, the violator shall forfeit to the state not less than $100 nor more than $500 for each violation.

It can be seen from this brief description that rather severe penalties are provided for violations of the stock transfer tax law. No instance has been found in which any of the penalties have ever been imposed or attempted to be imposed. Whether this is the result of unanimous compliance with the law, lack of energetic enforcement, a feeling that the penalties are unrealistically severe, or of other reasons is not known.

Taxpayer Enforcement

Perhaps the strongest inducement to payment of the tax for those who might be tempted to evade it is found in a provision which imposes neither a fine nor imprisonment as a penalty. It provides that the courts of the state may not be used to determine controversies between parties concerning stock transfers upon which the tax due was not paid and that evidence will not be received in any case between private parties concerning such a transaction.[90] Massachusetts, New York, and Pennsylvania have a similar provision. Non-payment of the tax does not abrogate the transfer

86 Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 3.

87 Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 4. Perhaps through an oversight, no maximum period for imprisonment is provided for this offense.

88 Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 5.

89 Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 6.

90 Tex. Civ. Stat. (Vernon, 1948) art. 7047m, sec. 7.

but bars the persons from asserting in court any rights they may have as a result of such transfer. For example, it has been held that the donee cannot prove the gift of stock if the tax stamps have not been appropriately affixed. If a seller transferred stock to a purchaser and failed to pay the tax, the seller could not use the courts to recover the purchase price from the buyer. When it is remembered that the duty to buy and affix the tax stamps is placed on the seller, it can be seen how effective this provision of the law is in inducing payment of the tax. A person selling stock would be reluctant to jeopardize the collection of the sales price merely to evade payment of the tax.[91]

Coverage

From the viewpoint of the taxpayers who do pay the tax and of the state in realizing a full return on the taxes it imposes, it would seem important for any tax that attention be given to the question whether substantially all persons who are liable for the tax are paying it. Incomplete coverage or collection discriminates against the taxpayers who pay what is due. Both non-payment and under-payment of a tax are undesirable. Non-payment may result from conscious evasion of the law--not knowing that the tax law exists or not knowing that the particular transaction is taxable. Underpayment may result from conscious evasion or from inability to compute properly the tax due.

An examination of the material in this and the preceding section of this chapter indicates that the stock transfer tax might be expected to encounter some special problems regarding coverage. Unlike some taxes where the taxpayer submits the data from which he computed the tax due to the tax administrator, a taxpayer, in paying the stock transfer tax, merely buys tax stamps and attaches to the proper documents the stamps he believes required. In the case of the stock transfer tax, then, the tax administrator does not usually participate in any way in the process by which the tax is computed; he is not there to make corrections at the time the tax is paid. Also, this tax, unlike many others, applies to a great variety of situations. This, plus the fact that the tax law has had a limited interpretative development in Texas, may mean frequent questions of the law's applicability to a particular transaction. If the taxpayer resolves the doubt in his favor, a loss of revenue results. Location of taxable transactions on which a tax is due would seem to pose a difficult enforcement problem. In fact, learning of transfers that take place outside the established security marketing channels would seem to be practically impossible. Grave doubts of the coverage completeness of the Texas tax have been expressed in tax administration circles. In fact, it has been estimated that about 50 per cent

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91 For a discussion of the operation of this sanction see Christy and McLean, Transfer of Stock (2d ed., 1940), pp. 584-585.

of all taxable transfers go untaxed. However, there are no readily available data upon which a truly accurate estimate of the tax's coverage may be made.

Given the number and nature of the transactions subject to the tax, complete coverage or full collections for the stock transfer tax is probably less attainable than for most state taxes. As a practical matter, how is the Comptroller to learn, for example, that A in Dallas has made an agreement to sell 100 shares of a Delaware Corporation to B in Chicago, A accepting B's telephonic offer?

The tax law, however, had given the tax administrator several potent weapons for any war on evaders. Records of taxable transactions must be kept; and failure to keep these records can result in the imposition of severe penalties. Even those conducting exempt transactions are required to make records adequate to demonstrate that the transaction is truly exempt. In addition, the administrator has been given the important power of auditing those records at any time. Coupling stringent record-keeping requirements with adequate auditing powers is significant. But the powers of audit and inspection have lain dormant; they have apparently never been used to determine whether persons engaged in marketing securities are complying with the tax law. How diligently those required to keep records are complying with that provision is not known. It would not be surprising, though, to find that some who kept the required tax records for a number of years since 1941 and have received no visits from enforcement personnel might have become less diligent in recent years. The keeping of records for tax audits that never occur might seem in time to involve needless expense and effort.

The fact that one-half of the annual revenue is derived from tax stamp sales to out-of-state brokers and banks may indicate that the transfers on the books of Texas corporations resulting from trade in their stocks on the major exchanges represents the class of taxable transfers receiving the most complete tax coverage. On the other hand, the careful policing of transactions on the New York exchanges by both the Exchange and Curb itself and by the Securities and Exchange Commission may help account for the substantial out-of-state stamp sales. The reasons for this phenomenon are not definitely known, but these speculations may have some accuracy.

No Alternate Method of Payment

New York and Pennsylvania permit payment of the tax by purchase and attachment of tax stamps or in cash without using stamps. This recently added method has become popular with the taxpayers. During 1949-1950, about 85 per cent of New York stock transfer tax revenue was obtained by the cash payment route.[92] Texas permits payment of the tax to be made only by purchasing tax stamps and affixing them to the document.

[92] State of New York, Annual Report of the State Tax Commission, 1949-1950 (Albany: Williams Press, Inc., 1951), Table 12, p. 52.

No Administrative Fund

The tax law does not set aside a percentage of revenue from the tax to finance its enforcement; that is, the act does not establish a special administrative or enforcement fund. The administrative costs incurred by the Comptroller's Office in the administration of this tax are paid out of administrative funds for the oil and gas tax, which are but 2 of the 18 taxes administered by the Gross Receipts Division of the Comptroller's Office. The administrative cost of this tax is quite small, involving primarily one hour a day of one employee, mailing costs for sending stamps to county clerks and taxpayers, and the cost of printing and storing stamps. In noting the absence of a special administrative fund for this tax, is is not intended to indicate that such funds are either desirable or undesirable.

Allocation of Revenue

Although the act expressly declares that the tax is assessed on the sale, delivery, or transfer of stock and the Attorney General has classified it as an excise tax,[93] the practice in allocating its revenue has been to treat it as an occupation tax. When originally enacted, one-fourth of the revenue was allocated to the Available School Fund and three-fourths to the Omnibus Tax Clearance Fund.[94] It is remembered that the Constitution requires one-fourth of the revenue from occupation and poll taxes to be allocated annually to the Available School Fund.[95] The allocation of one-fourth of the revenues to the public free schools has been continued.

When a temporary 10-per-cent increase was enacted by the 1950 Special Session of the 51st Legislature, three-fourths of the added revenue was allocated to the newly-created State Hospital Fund. When the temporary rate increase was made permanent in 1951, the above allocation was also adopted.[96] Thus, one-fourth of all revenues now go to the Available School Fund, three-fourths of each 3 cents collected goes to the Clearance Fund, and three-fourths of each three-tenths cent goes to the State Hospital Fund. Moneys in this Clearance Fund go to support the public assistance program, the teacher retirement system, and the highway system.

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93 Op. Tex. Atty. Gen. No. 0-3713 (July 29, 1941).

94 Acts 47th Leg., R.S. 1941, ch. 184, art. XV, sec. 2.

95 Tex. Const., art. VII, sec. 3.

96 Acts 52d Leg., R.S. 1951, ch. 402, sec. XXV.

SECTION 5 - RESULTS OF OPERATION

Analysis of Returns

Since 1941, there has been a steady increase in the amount of revenue obtained from the stock transfer tax. However, there has been a similar increase in the total revenue of the State; hence, this tax has provided about the same percentage of the state's total tax income throughout its history. Regardless of the increase in collections from the transfer tax, the assessment has never provided as much as one per cent of the state's total revenue and, therefore, is generally considered of only secondary revenue importance. (See Table Stock - 4.)

Comparison of Rates

Texas, five other states, and the federal government impose a transfer tax on stock transactions. A few of these states tax transfers as a part of their documentary tax. Before any comparison of rates is made, it should be noted first that some states levy the tax on the basis of the market value of the stock and others on par value. As indicated previously, there is generally no necessary relationship between par value and market value, and often the selling price of the stock exceeds its par value, especially during periods of a high-level economic activity. Therefore a comparison of rates is not as meaningful in a discussion of the stock transfer tax as in consideration of a tax where the basis is always the same--if the rate were based on packages of cigarettes or gallons of gasoline, for example.

The tax rate in New York is levied according to a graduated scale as follows: stock selling under $5 a share, 1 cent a share; at $5 but less than $10 a share, 2 cents; from $10 to less than $20 a share, 3 cents a share; above $20 a share, 4 cents a share. If no sale is involved, the rate is 2 cents a share. Therefore in the last instance, which would include transfers resulting from gifts and inheritance, the rate is not dependent upon the value of the stock but on the purpose of the transfer. However, the market value of the stock determines the New York rate on sales, which accounts for most of the transfers.

Pennsylvania and Massachusetts levy a flat rate of 2 cents per $100 of par value or fraction thereof and 2 cents a share on stock with no-par value. Texas assesses its tax on the same basis as Pennsylvania and Massachusetts but uses a 3.3-cent instead of a 2-cent rate.

TABLE STOCK 4

Texas Stock Transfer Tax Receipts

Aug. 1941 - Aug. 1950

Year Ending	Total Taxes and Licenses	Stock Transfer Tax	Per Cent Stock Transfer Tax is of Total Taxes and Licenses
August 1941	$ 133,059,077.	$ 9,791.	.073
" 1942	151,136,008.	67,487.	.044
" 1943	149,969,852.	91,112.	.060
" 1944	156,671,527.	67,180.	.043
" 1945	168,386,666.	103,593.	.061
" 1946	205,369,694.	110,383.	.050
" 1947	229,741,552.	103,741.	.045
" 1948	300,643,046	160,316.	.035
" 1949	309,936,832	201,465.	.065
" 1950	346,484,840	271,180.	.078

SOURCE: Annual Report of Comptroller of Public Accounts, 1941-1950.

The federal tax considers both the market value of the stock, like New York, and the par value, like Texas, Massachusetts, and Pennsylvania. The rate of the tax is either 5 or 6 cents, depending on the market value. If the selling price of the stock is $20 a share or more, the rate is 6 cents; if the selling price is below $20, the rate is 5 cents. After determining the rate by the market value, the amount of the tax is based, as in Texas, on $100 par value or fraction thereof, or on stocks without par value, on each share. However, as previously mentioned, the federal tax is different from the Texas tax in that the rate is determined by market value rather than being levied at a flat rate, and the rate levied is somewhat higher than that imposed by Texas.

The above data indicate that the Texas rate is substantially higher than those of Pennsylvania and Massachusetts, which levy the tax on the same basis as this state. However, it seems that the Texas rate is significantly lower than that which would be imposed in the usual case under New York and federal law.

Postage and Insurance

The revenue results of this tax have been affected by an administrative problem which has arisen in its operation. Not infrequently, requests for stamps are mailed to the Comptroller without enclosing sufficient money to cover the postage and insurance necessary to fill the order. It has been estimated that more than half the orders requesting stamps fail to include sufficient money for postage. As a result, the Comptroller's Office is obliged to pay from $200 to $300 annually for this service. The large brokerage houses and banks, which are generally regular customers, are usually observant of this requirement, but individuals and small corporations which seldom purchase stamps are particularly negligent about defraying postage and money order fees. In an effort to alleviate this situation, notices re-emphasizing the need for sending sufficient return postage funds are included in the return envelope of each order neglecting to pay for the service.

Operational Effects of the Tax

The structure of the tax law, the fact that the great bulk of stock transactions are consummated on the floor of one of the two New York exchanges, the fact that securities are marketed without regard to state lines, and nature of the security-marketing channels may mean that the stock transfer tax, in its operation, has some effects that may not have been anticipated when the law was enacted. Some of the details of these factors have been discussed in preceding sections of this chapter.

The contrast between effects of the tax upon the operations of two Texas security marketers--the local office of a national brokerage house and the over-the-counter security dealer--may be illustrative. For reasons set out in section 3, much of the business conducted by a broker will not be within the reach of the Texas tax. This is principally the result of the fact that the broker acts as his customer's agent and does the necessary acts outside of the state and of the prevalent practice of dealing in stock held in "street name." The security dealer, however, more frequently acts in his own behalf and so performs his functions within the state. Obviously, he is subject to the tax in such cases. The facts of the marketing environment and the limits on the jurisdiction of the state to tax mean, then, that the law will operate to tax a greater portion of a Texas security dealer's business than that of a broker operating in the state.

Taxation of a transfer on the stock record books of a Texas corporation, even though the transaction has no other connection with Texas, may also have some operational effects that were not expected. The assessment of a tax in cases of this kind means that persons trading out-of-state in Texas stock and desiring a change in the transfer records must pay a Texas tax if the stock sold is that of a Texas corporation but not if it is that of a foreign corporation. Whether this deters non-residents from trading in Texas stocks on the major exchanges is not known. Since the tax does not represent a major portion of the transaction price, it may not do so.

SECTION 6 - SUMMARY AND PROBLEM AREAS

The stock transfer tax imposes a transaction tax on all transfers of documentary proprietary interests in corporations or similar business units. The tax is due whether all or only a certain part of the stock transaction took place in the state and whether the transfer was the result of a sale, trade, or gift. The tax is paid by affixing tax stamps bought from the state to the appropriate document.

In the preceding examination of the administration, collection, enforcement, and operation of the stock transfer tax, several problem areas have been disclosed. As mentioned in the discussion of the limits of this study in the Introduction to this volume, the purpose of this section is to summarize some of the more significant problem areas in the tax which pose policy questions and to indicate some of the readily apparent approaches toward their solution. In delineating the problem areas, it is not intended to indicate that any change in the present law is either desirable or undesirable; and in setting out the possible approaches, it is intended merely to report possibilities to stimulate thought concerning the matter.

Several problem areas are apparent:

(1) Use of a tax basis not closely related to selling price.

(2) Exemptions.

(3) Absence of energetic enforcement.

(4) Operational effect of the tax on domestic corporations and Texas dealers.

(5) Absence of an alternate method of payment.

The Basis of the Tax

Indications are that par value was adopted in the original enactment as the basis for computing the tax due on a transfer because it was a convenient measure of price at which the stock was sold. The tax on a transfer is 3.3 cents per $100 of par value or any fraction thereof. However, as discussed earlier, the par value of the stock may have only a limited relationship to the proceeds of the transaction received by the seller who must pay the tax. New York, from which Texas borrowed the tax law, has shifted to a market-value basis. If the thought is that the amount of tax should relate to the taxpayer's general ability to pay as measured by his proceeds from the transaction, it would seem that market value bears a closer relationship to this than par value. The great bulk of transfers involve stock which is listed on the various

stock exchanges; this means that the market price of stock involved in a given transaction for any given date is readily available to the taxpayer and the tax administrator. Use of market value or price instead of sales proceeds obviates the need to be concerned with deductions for brokerage fees and other expenses.

While the Texas tax is 3.3 cents per $100 of par value of the shares transferred, it is 3.3 cents per share in the case of no-par-value stock. The rate for shares without designated value appears to involve an estimate that the average selling price of such shares is $100; but in one case, the selling price could well be just a few dollars per share and in another well over $100. It would seem, then, that tax paid on transfers of no-par-value stock would have even less relationship to the market value of the shares sold than in cases of a stock having par value.

It may be felt appropriate to consider whether par value or market value is the more scientific basis for the assessment of the tax.

Exemptions

It has been ruled that the delivery or transfer of the original issue of stock from the corporation to its subscriber is not taxable. In making this interpretation, the Attorney General conformed to the conclusion reached under the New York act, from which the Texas law was borrowed. The transaction involving the original issue is not expressly exempt, but it was found that such was the legislative intent. The question might be raised whether this transaction should be exempt. However, as was mentioned in some detail when this was discussed in section 3 of this chapter, the original issue of stock constitutes a transfer that has some important differences from a transfer resulting from an ordinary sale of stock.

The question might also be raised whether the transfer of documents representing rights to buy stock should be taxable. Texas taxes the transfer of "certificates for rights to stock." Subscription warrants have been declared by the Attorney General not to be such certificates. Option warrants have been held not taxable under similar New York language. Although these warrants are probably exempt in Texas, no administrative interpretation is available; so this is not certain. As explained in section 3, these documents represent valuable rights and are frequently the subject of active trading. They are taxable under the federal provision taxing "rights to subscribe for or to receive stock." If it were decided that the transfer of such documents is so like the transfer of stock and the other interests taxed that they should also be taxed, certain problems of determining the basis would have to be met. The par value of the stock which such a document represents the right to buy would seem to be an unsatisfactory basis upon which to assess the tax.

Field Enforcement

One of the striking aspects of this tax's operation is disuse of the power to make audits of the tax records certain taxpayers and others dealing in stocks are required to keep. As explained in sections 4 and 5, a taxpayer's only contact with the tax administrator is his request to purchase stamps. It would seem, then, that spot checks of stock transactions as reflected by the required records would be an important step in the enforcement of the tax.

An examination of section 3 of this chapter will show that there are many situations to which the tax is applicable but which are difficult for tax enforcement personnel to discover. Thus it seems that this tax, especially, must depend upon the taxpayer to learn that he is engaged in a taxable transaction, to compute the tax due, and to pay it by affixing the stamp.

These factors in field enforcement of the tax may deserve special legislative attention and may indicate that thought should be given to a means for providing whatever is needed to facilitate energetic enforcement of the tax. Payment of the tax by only part of those who owe it works a discrimination against those who pay and means that the full revenue potential of the levy is not realized.

Operational Discriminations

In having the effect of taxing a greater portion of the business of the over-the-counter security dealer than that of the brokerage house and of taxing the transfers on the books of corporations chartered in Texas when that is the only contact of the transaction with the state, the tax in its operations may be reaching results not anticipated when it was enacted. Some of the effects of the tax may be resulting in unintended discriminations. Reasons for these results are explored in sections 3 and 5 of this chapter.

Some of these reasons are beyond the reach of legislative remedy, such as the practical and legal limits on the power or jurisdiction of the state to tax and the customs and structure of security marketing. However, in any consideration of the assessment on stock transfers, this aspect of the tax should be kept in mind.

Alternate Method of Tax Payment

Payment of the stock transfer tax is made by buying tax stamps from the Comptroller and affixing the proper number of stamps to the appropriate document. When a tax employs the stamp method of payment, certain additional administrative costs are experienced. For example, the costs of printing, storing, handling, and shipping stamps are incurred. Apparently to reduce cost to the state and to minimize handling costs and inconvenience to the taxpayer, several states now permit taxpayers to make their transfer

tax payments in cash without buying stamps. Careful keeping and auditing of tax records permits certain classes of taxpayers to use this method. A major portion of the New York tax is now paid in this manner.

In considering any such change in the Texas law, account should be taken of the fact all persons dealing in secutities in the state must be registered with the Secretary of State. [97] It is probable that the large proportion of stock transfers in Texas involve a registered dealer, agent, or broker. This registration might be considered as the control device for those permitted to use the cash payment method. Before any change is made, it may be necessary to examine the matter in detail; it is possible that this payment device is workable only in a state like New York, where the major stock exchanges are located.

In conclusion, it might be noted that this excise tax touches an area of economic activity that is somewhat complex and one in which essentially the same transaction may be formulated in a variety of ways. The tax law has had only a limited interpretative development in Texas so that substantial questions of the tax's applicability have not yet been authoritatively determined. About one-half its revenue is the result of the tax stamp sales to persons outside Texas. It has never developed into a major tax-revenue producer, presently yielding about a quarter of a million dollars a year and something less than one per cent of the state's total tax revenues. Although it is a minor tax measured from the viewpoint of its comparative revenue yield, it does touch a number of people and transactions and so may deserve attention.

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97 Tex. Civ. Stat. (Vernon, 1948) art. 600 a, sec. 5.

Chapter V

ALCOHOLIC BEVERAGES TAXES

SECTION 1 - HISTORICAL AND LEGAL DEVELOPMENT

In any discussion of alcoholic beverages, taxation for revenue cannot be completely isolated from regulation designed to control liquor traffic, use, and consumption. Both state policy decisions and administrative machinery regarding these two functions are closely interwoven. Although the following discussion is primarily concerned with taxes, attention is given to the development of other than purely tax aspects.

Alcoholic beverages are of three general types, those produced by the fermentation of cereal malt, those produced by fermentation of fruit juices, and those distilled from fermented cereals. Cereal malt beverages include beer, ale, bitters and stout; wine is produced from fruit juices; and distilled spirits include a variety of liquors, whiskies, brandies, rums and other intoxicants produced by distillation.

Beer

Beer was probably the first alcoholic beverage produced by man, and its origin is hidden in antiquity.[1] Herodotus, the early Greek historian, credited the beginning of brewing to Isis, the Egyptian goddess of fertility and motherhood. Babylonian clay documents estimated to have been prepared around 6000 B.C. purportedly depict a crude brewery in operation. Sixteen distinct types of Babylonian beer are recorded by 4000 B.C., and four different kinds were in use during the reign of the Egyptian Pharoahs about 3000 B.C. China used a fermented beverage resembling beer as early as 2300 B.C., and the Incas made beverages from fermented corn long before the discovery of America. Cereal beverages were also common in ancient Germany, Spain, and France. A visitor to England in the Fourth Century B.C. recorded the production of a fermented beverage from grain and honey. Central American Indians greeting Columbus on one of his voyages in 1502 are said to have presented him with a beverage made from fermented maize and resembling English beer. The brewing of beer was controlled by guilds during the Middle Ages, especially in England and Germany. Pasteur's studies of yeast fermentation in the 1860's contributed to the scientific production of beer.

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[1] The material for the history of beer is drawn largely from Encyclopedia Americana, (New York: Americana Corp., 1946), vol. I, p. 357 and Encyclopaedia Britannica (Chicago: Encyclopaedia Britannica Corp., 1951), vol. 3, pp. 313-314 and vol. 4, p. 101.

Wine

Although the origin of wine is almost as ancient as the first production of beer, it is generally believed that wine was first prepared in the area surrounding the Caspian Sea.[2] Egyptian records mention wine as early as 2400 B.C., and the Chinese record its use around 2000 B.C. At about that time Hammurabi, the great Babylonian lawgiver, is reputed to have decreed the death penalty for a wine-seller who permitted riotous assemblies in his place of business. There are many Biblical references to wine and the growing of grapes, and the Greeks knew wine by the Eighth Century B.C. The Phoenicians are credited with transplanting vines to France around 600 B.C. The Romans adopted viniculture from the Greeks, and, after their capture of Gaul (France), wine-making flourished throughout the Mediterranean area and Western Europe. Early explorers of the American continent reported an abundance of wild grapes, and the growing of grapes was encouraged by the Franciscan fathers in California as early as 1739.

Distilled Spirits

The distillation of alcohol from fermented cereals developed much later than either the brewing of beer or the manufacture of wine.[3] The word "alcohol" is derived from Arabic, and its distillation was supposedly effected by Arabian alchemists. Use of distilled fermented liquors was recorded in the 11th Century, and distillation had become common by the 16th and 17th Centuries. The most common term attached to alcoholic beverages, "whisky," reputedly evolved from an old Irish word "usquebaugh." The production of whisky early became a major occupation of the Scots. Other distilled spirits are brandies (made by distilling wines made from various fruits), rum (made from the fermented products of sugar cane), gin (distilled from cereal mashes containing juniper seeds) and cordials and liqueurs, (compounded of alcohol, flavoring agents, and sugar).

Early Taxation of Alcoholic Beverages

Ale was first mentioned in E nglish law in 694 when a Welsh king levied a tax payable in ale.[4] In 1728, ale-booths became subject to statutory regulation, and the Norman princes fixed the price of ale. The regulation of brewing on the Continent was first undertaken by the brewers themselves, who established guilds in the 14th Century. Licensing began in England in 1621 when ale houses were licensed and a tax, graduated according to retail price, was first imposed on ale during the reign of Charles II (1660-1885).

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2 This discussion of the history of wine is based chiefly upon Encyclopedia Americana, vol. 17, pp 461-462 and Encyclopaedia Britannica, vol. 25, p. 652.

3 A discussion of the history and distillation of alcohol may be found in Encyclopedia Americana, vol. 9, p. 184 and Encyclopaedia Britannica, vol. 25, p. 569.

4 Encyclopedia Americana, vol. 1, p. 357, and vol. 4, p. 476.

Alcoholic Beverages in Colonial America

By the time colonization began in New England, brewing, the fermenting of wines, and distillation were all sufficiently advanced to be of general knowledge. The colonies early faced the problem of regulation of alcoholic beverages.[5] As early as 1633 the West India Company maintained a brewery in the area between the present Wall and Hudson Streets on Manhattan Island. The distillation of rum was started by the Dutch on Staten Island in 1638, using molasses imported from the West Indies. Other alcoholic beverages were distilled in the colonies on a commercial scale as early as 1648.

The Massachusetts Bay Colony was probably the first to institute a system of licensing when it required prospective liquor dealers to secure permission of the governor beginning in 1633. Eleven years later, that colony imposed a revenue tax on liquor. The same year, 1644, New York imposed an excise on beer, wine, and brandy. Connecticut was also a leader in liquor regulation; in 1650, it taxed domestic manufacture of liquors and imposed one of the first import tariffs levied on the North American continent. Five years later, the colony went even further by fixing liquor prices.

Virginia also introduced several innovations in the alcoholic beverage regulation. After attempting the prohibition of all beverages except beer from 1644 to 1652, Virginia's Great Assembly granted an apparently exclusive monopoly to a citizen to "distill and brew" within that colony. In 1677, Virginia restricted the number of licenses to two taverns in each county, a control device now utilized by some states. Licensing began in South Carolina in 1686.

Federal Regulation and Taxation

The first Congress under the federal Constitution, however, imposed an import duty on distilled spirits during its first session in 1789.[6] These duties were raised in 1790, and in 1791 domestic beverage production was made subject to tax at a lower rate.

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[5] Acts of colonial legislative bodies concerning alcoholic beverages may be found in "Liquor Regulation in America 1619-1920," Congressional Digest (January , 1933), vol. 12, no. 1, p. 2. References to early manufacture of alcoholic beverages are contained in Harvey W. Wiley, Beverages and Their Adulteration (Philadelphia: P. Blaikston's Sons and Co., 1919), at pp. 186, 293, 297.

[6] "Acts of Congress Imposing Duties or Internal Revenue on Distilled Spirits (1789-1933), "Leg. Ref. Service, Library of Congress, August, 1933, unpublished manuscript, Texas State Library) p. 1.

The latter excise was strongly resented by farmers in sections of Pennsylvania, Virginia, and North Carolina where the distillation of alcoholic beverages was a profitable sideline to agriculture. Their resentment was climaxed by the so-called Whiskey Rebellion. After President Washington ordered the militia into rebellious areas in 1794, the disturbance was quelled without bloodshed. Besides assuring the future collection of such excises, the incident marked the first instance of a president employing his executive powers under the new Constitution.

Retail dealers in foreign distilled spirits were first required to secure federal licenses under an act of 1794; and distillers were included in 1797. Not until 1862 were federal license taxes required of wholesalers and retailers generally. Except for wholesalers' and retailers' licenses, these taxes and licenses have continued in effect with varying rates to the present date.

Alcoholic Beverage Taxation Under the Republic of Texas

The first taxes on distilled spirits and malt beverages in Texas were enacted in 1836 as import duties to finance the fledgling republic. This duty amounted to 45 per cent of value and made no distinction as to proof or type.[7]

The first graduated ad valorem rates were applied the next year, and malt liquors were exempted. The conclusion of a treaty with France in 1839 reduced imports on French liquors, and they were abolished altogether by proclamation of President Mirabeau B. Lamar in February, 1840, apparently as a gesture to influence France to guarantee a pending Texas loan.[8]

The first Texas act requiring retailers of wine and spirituous liquors to secure licenses was passed on June 12, 1837. They, as well as owners of inns and taverns, were subjected to a tax of $100 plus an additional $100 if engaged in both retailing and the business of operating a tavern or inn.[9] Thus a rough differentiation between "on-premise" and "off-premise" licenses was created. This distinction existed only for wine and liquor, however, for persons selling cider or malt beverages exclusively were exempt.

Two significant developments occurred in 1840.[10] For the first time, a tax was levied on spirituous liquors distilled in the republic at the rate of five cents per gallon. Perhaps to produce a general conformity between internal taxes and imposts, specific, rather than ad valorem, rates were prescribed for some imported distilled spirits and wines. Second, all retail businesses were subjected to a license fee of $100 and a tax of 50 cents on

7 Gammel's Laws, vol. 1, p. 1207.

8 Ibid., vol. II, pp. 660-662.

9 Ibid., vol. I, p. 1321.

10 Ibid., vol. II, pp. 191, 200, 216, 272.

each $100 of merchandise sold. Retail liquor dealers and inn and tavern owners were liable for these taxes in addition to other license fees. The policy of imposing special levies upon the alcoholic beverage industry in addition to general business taxes was thus initiated, and has been followed almost continuously since that date. At the same time, a distinction was made between retail and wholesale dealers, with higher rates imposed on retailers. This pattern of alcoholic beverage taxation was not altered during the remaining years of the republic. In fact, variations of this approach were utilized throughout the remainder of the 19th Century.

State Licensing

In 1848, after Texas was admitted to the United States, the specific license taxes for wholesalers and retailers of alcoholic beverages in quantities of a quart or more were deleted, leaving these businesses subject only to the general business tax on each $100 of merchandise purchased.[11] The tax rate on retailers selling in lesser quantities remained at a fixed annual rate, but they were not liable for the tax based on volume of purchases.

An anti-liquor movement climaxing in 1855 is credited with decreasing both the number of retail liquor establishments and revenues from the alcoholic beverage taxes.[12] Under an act approved in 1856, counties were authorized to collect a tax of $250 from every person desiring to sell spirituous, vinous, or other intoxicating liquors in quantities of less than a quart. Revenues, fines, and penalties from this tax could be only for the payment of general and petit jurors.[13] This permissive county levy apparently replaced the state tax, since the license tax for these retail outlets was omitted from the revised tax statute in 1858. The state tax on purchases for businesses selling larger quantities of alcoholic beverages (wholesalers) was retained.

Alcoholic Beverages and the Civil War

The 1848 and 1858 tax rates on alcoholic beverages were re-enacted by the Legislature in 1861 after Texas seceded and joined the Confederacy. Additional financial burdens resulting from the war did not produce a marked change in state taxation until 1862, when the tax on gross sales of alcoholic beverages and other commodities was increased. The first Texas taxes on breweries and distilleries were levied in the same act at $20 and $50 respectively.[14]

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11 Ibid., vol. III, pp 151-152.

12 E. T. Miller, A Financial History of Texas, University of Texas Bulletin No. 37. (Austin: University of Texas Press, 1916), pp. 112-113.

13 Gammel's Laws, vol. IV, p. 247.

14 Ibid., vol. V, pp. 494, 495.

By March of 1863, the need for revenue had become so critical that the general tax on gross sales was doubled.

In an apparent effort to conserve corn for war and related purposes, the tax on distilleries was raised to $1,000 per still, and in December of 1863, county courts were authorized to ban distilling as "prejudicial to public subsistence."[15]

A complete overhaul of all state taxes was effected about this time. The need for revenue had evidently reached drastic proportions, and new occupation taxes and the first specialized corporate taxes were imposed. In an act titled "Income Taxes on Sales of Distilled Spirits, Fermented Liquors and Wines,"[16] graduated rates based on sales prices were prescribed. Beer, though not specifically mentioned, was evidently considered a "fermented liquor." Wines made in Texas were exempt. Although designated an "income tax" this new levy was in reality only a variation of the 1848 act combining volume of trade with sales price.

Counties, cities, and towns were prohibited from levying taxes on these subjects, apparently repealing the permissive legislation discussed above. County courts, however, were authorized to determine that alcoholic beverages conformed to provisions of the law concerning proof and adulteration.

Enacted strictly as a war-time measure and providing unusually high rates, the taxes were to be collected only until the conclusion of the war and ratification of a treaty with the United States. They remained in effect for slightly less than one year.

The tax on stills was reimposed on a graduated scale on November 15, 1864, and the taxes graduated according to sales price per gallon were replaced by a five-per-cent levy on all sales of alcoholic beverages, including beer and wine. The quantity unit dividing retailers from wholesalers was changed from a quart to a gallon, and flat-rate levies of $250 were charged retailers of alcoholic beverages in addition to the $100 tax imposed on all retailers.[17]

Under the "Reconstruction"

The end of confederate rule in Texas did not formally end until the meeting of the constitutional convention of 1866. This convention, by ordinance, increased the sales tax for persons selling vinous or spirituous liquors in quantities of less than one quart. Bars, drinking saloons, and dram shops were taxed at a flat rate. Distilleries were taxed $30 for each still with a capacity of 80 gallons or less and $60 for each with a larger ca-

15 Ibid., pp. 613, 702, and 703.
16 Ibid., pp. 670-674.
17 Ibid., pp. 813-815.

pacity.[18]

As soon as the Legislature met, it enacted a general graduated income tax on each "person, firm, corporation or association doing business" which replaced sales tax so far as dealers in alcoholic beverages were concerned. At the same time, the license tax on establishments was re-enacted on the basis of sales of a quart or less, $300, and sales of more than a quart but less than a gallon, $100.[19] Taxes on breweries and distilleries were omitted.

The Tax Pattern Stabilizes

Although the income tax lasted only until 1871 and was replaced by a general business tax based on gross purchases, the policy of graduating license taxes according to quantities of individual sales was followed until the advent of prohibition in 1919. The dividing unit varied between a quart and a gallon. Domestic wine was exempted in 1870 and domestic beer in 1871. A $50 tax on breweries was reimposed in 1871, but both distilleries and breweries were omitted from tax acts after that date.[20] Beginning in 1876, persons selling beer exclusively were subjected to a lower license tax, and this procedure has been generally followed.[21]

In 1879, the so-called "bell punch law" was enacted, introducing a novel method of taxing alcoholic beverages.[22] Besides the usual annual graduated license taxes on individual sales, a tax of two cents was levied on each spirituous, vinous, or mixed drink and one-half cent on each drink of beer. Before serving a drink to a customer, proprietors of retail establishments and their employees were required to register it on machines furnished by the Comptroller for a $10 annual fee. One machine was required to be marked "alcoholic" and the other "malt." Both were designed to ring a bell as each drink was registered. Cities and towns were authorized to levy taxes of 1/4 cent and 1/8 cent on each alcoholic drink or drink of beer, respectively. This innovation was discarded two years later in 1881 and alcoholic beverages taxes were restored on the previous base of total purchases. The only significant change between 1881 and 1907 was the requirement, adopted in 1897, that prescription liquor dealers in dry areas pay a $200 license fee.[23]

Local Option

Before adoption of the Constitution of 1876, the prohibition of sales of alcoholic beverages in specific areas or governmental units was usually accomplished by legislative act. An early example of this practice was an act of April 8, 1861, prohibiting the sale of intoxicating liquors -- whether alcoholic, malt, distilled, or brewed - within three miles of Baylor University, then located at Independence.[24] The Constitution of 1867 provided that the Legis-

18 Ordinance No. 5 of Constitutional Convention of 1866, Gammel's Laws, vol. V, p. 890.
19 Gammel's Laws, vol. V, p. 1009.
20 Ibid., vol. VI, p. 947.
21 Ibid., vol. VIII, p. 1079.
22 Ibid., pp. 1371, ff.
23 Ibid., vol. X, p. 1278.
24 Ibid., vol. V, p. 432.

lature could prohibit the sale of intoxicating beverages "in the immediate vicinity" of any college or seminary, provided it was not located in a county seat or the state capital.[25] By 1875, this practice had become so common that the sale of alcoholic beverages within two miles of 36 named places was prohibited by legislative act and one such prohibition repealed.[26] The next year statutory prohibition was provided for 86 places.[27] This condition undoubtedly influenced the Constitutional Convention of 1875 to provide for local option. The first enabling act under this provision was passed the same year.[28]

In 1883, refunds of license fees were authorized for liquor dealers prevented from utilizing a license for the full period of issue because a local option election voted the area "dry."[29] This provision is found in the present Liquor Control Act, and has consistently been the only refund permitted.

Enforcing Local Option

From 1907 to 1920, alcoholic beverages legislation was concerned largely with enforcement of local option, but several acts dealt with licensing. The Legislature took several significant steps in 1907. Besides raising the license fee for retail dealers and enacting extensive regulatory provisions, it levied two new taxes on alcoholic beverages.

Wholesale dealers in spirituous, vinous, and malt liquors or medicated bitters capable of producing intoxication were required to pay a quarterly tax of one-half per cent of gross receipts to the Comptroller.[30] At the same time, the general business tax graduated according to gross purchases, which had replaced the income tax in 1871 and been increased several times, was repealed.[31] Retail dealers in non-intoxicating malt liquors such as "Uno," "Ino," "Frosty," "tin-top," and "tee tottle" in dry territory were required to pay a state license tax of $2,000. Cities, counties, and other local subdivisions could levy a tax of one-half that amount.[32] Cold storage places in dry areas where intoxicating liquors were kept for other persons were subject to the same tax rate. In addition, the Legislature enacted a license tax of $4,000 on solicitors for intoxicating liquors in dry territory. Counties, cities, and towns could collect half these rates.

License fees for retailers of intoxicating liquors were left unchanged in a subsequent enactment revising the tax statute extensively. The Comptroller was authorized to collect a preliminary permit fee from each applicant. Licenses could be issued by the county clerk only after approval of county courts following public hearing, payment of the fee, and the filing of a lengthy statement by the applicant testifying to his knowledge of the law. Many of

25 Tex. Const. of 1867, sec. 48; Gammel's Laws, vol. VII, p. 427.
26 Gammel's Laws, vol. VIII, p. 330.
27 *Ibid.*, pp. 595, 612, 621, 626, 657, 733.
28 *Ibid.*, p. 862.
29 *Ibid.*, vol. IX, p. 416.
30 *Acts* 30th Leg., 1st C.S. 1907, ch. 18, sec. 11.
31 *Ibid.*, ch. 35, p. 57.
32 *Ibid.*, pp. 212-214.

these provisions were incorporated in the first Liquor Control Act adopted after prohibition repeal. Not more than one permit could be issued for each 500 inhabitants of any city, town, or justice precinct. Population was to be determined by multiplying by six the number of scholastics as certified by the county school superintendent.[33] According to available records, this is the only statute directly limiting the number of licenses that might be issued.

In 1913, all solicitations for alcoholic beverages, by mail or otherwise, in dry areas, were prohibited.[34] This act apparently rendered inoperative the $4,000 license tax on solicitors. Taxes on retail dealers of non-intoxicating malt beverages and cold storage places in dry areas, however, were unaffected until enactment of state-wide statutory prohibition in 1918. In addition, annual license taxes on retailers at $375 for distilled spirits and wines and $62.50 for malt liquors and on wholesalers at the rate of one-half per cent of gross receipts were still in force when prohibition became effective.

State Alcoholic Beverage Revenues, 1910 - 1920

It is interesting to note the fluctuations in revenue during the period 1910-1920 when prohibition sentiment was increasing in volume.

1910	$723,748	1915	$819,124
1911	788,022	1916	770,750
1912	783,687	1917	829,187
1913	821,250	1918	742,812
1914	819,062	1919	11,562

Prohibition figured prominently in the Democratic primary elections of 1910, 1914, and 1916 and in state elections of 1911 and 1919. Democrats favoring submission of a constitutional amendment were in the majority in 1910 and 1916. Some variation in revenues occurred in all election years, the most drastic being the decrease of 1916. The adoption of state prohibition in 1919 dried up a tax revenue source that had been producing nearly a million dollars annually.

National Prohibition

The question of prohibition began with the earliest colonies. Generally speaking, however, three great waves of prohibition sentiment have swept the United States.[35] The first, which reached its peak about 1855, resulted in the adoption of prohibition in many New England states. The influence of the movement was felt in Texas, producing a decline in state revenues from alcoholic beverage taxation in 1855 and 1856.

33 Acts 31st Leg., 1st C.S., 1909, pp. 293, ff.

34 Acts 33d Leg., 1st C.S., 1913, ch. 31, sec. 6, p. 63.

35 R. W. Kelsey, "Prohibition," Handbook of Citizenship No. 1, (Philadelphia: McKinley Publishing Co., 1929), pp. 6, 10, and 15.

The second great flurry of prohibition activity came in the latter part of the 19th Century, producing such organizations as the Prohibition Party, the Women's Christian Temperance Union, and the Anti-Saloon League. Nation-wide prohibition by constitutional amendment was first proposed in 1876 and figured prominently in politics throughout the late 19th and early 20th Centuries.

Actually, it was a revitalized continuation of this movement, combined with conditions occasioned by World War I, that eventually brought about national prohibition in 1920. The production of alcohol for war purposes became a prime necessity, and conservation of manpower was imperative. There began a kind of "creeping" statutory prohibition which climaxed with an act approved November 21, 1918, prohibiting the sale of distilled spirits for beverage purposes after June 30, 1919.[36]

The joint resolution proposing nation-wide constitutional prohibition was passed by congress December 19, 1917. It became effective January 16, 1920, one year after ratification, and there followed 13 years of the so-called "Great Experiment" in American government.

Prohibition in Texas

The Texas Constitution of 1876 contained a local option provision,[37] and the first state Prohibition Party convention was held in 1884. In the succeeding three years, the groundwork was laid for submission of the first "bone-dry" constitutional amendment in 1887. It was defeated, but eventually the major parties were forced to take cognizance of the prohibition issue, which received considerable legislative attention in the second decade of the 20th Century. The national pattern was repeated in Texas, with the Legislature in 1918 enacting measures providing for both State-wide prohibition and ratification of the eighteenth amendment to the federal constitution.[38] Thus Texas had statutory prohibition some two years prior to the effective date of national prohibition and almost a year before adoption of the state constitutional amendment.

Enforcement of Prohibition

The first national enforcement act was passed over the president's veto in October, 1919,[39] and was constantly being amended throughout the 1920's. Texas' first enforcement act was enacted in May, 1919, and during the next decade, major effort was directed toward obtaining strict observance of the law.

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[36] 40 Stat. 82, ch. 212, p. 1046.

[37] _Complete Texas Statutes_, 1928 (Vernon's) Constitution of the State of Texas, art. XVI, Sec. 20, p. XXXIV.

[38] Acts, 35th Leg., 4th C.S., 1918, pp. 37 and 200.

[39] 40 Stat. 305, ch. 85.

National prohibition was initially enforced through a Prohibition Unit of the Bureau of Internal Revenue.[40] In addition, the Customs Bureau, Coast Guard, and the Attorney General's Department exercised enforcement authority. For the first five years, administrative organization underwent constant change. Enforcement districts, originally numbering eighteen, were increased to forty-eight, coinciding with state boundaries and then later reduced to 24, comprised of judicial districts. A Bureau of Prohibition was created in 1927 and enforcement personnel placed under Civil Service jurisdiction.

Enforcement did not prove easy, however. A Senatorial investigation in 1926 revealed considerable evasion through the diversion of industrial alcohol and medicinal spirits, smuggling, and, in the South and Midwest, the production of moonshine liquor. The so-called "Wichersham Commission," in its report dated January 7, 1931, noted that of 17,972 persons appointed to the prohibition service from 1920 to 1930, 11,982 had been separated without prejudice and 1,604 dismissed for cause.[41] Almost 10 per cent of those employed were discharged for grounds including bribery, extortion, theft, falsification of records, conspiracy, forgery, and perjury. Among its conclusions, the Commission noted that, after ten years, there was still no adequate observance of the law. They did not recommend repeal, however. Effective enforcement depended largely upon local officials. In Texas, although the Comptroller was charged with responsibility for collection of minor license fees for such sales as were authorized, no special enforcement machinery was provided. Generally, state and local law enforcement officials were charged with this duty.

Repeal -- National and State

The prohibition issue became overshadowed by the problems of the depression. In a federal revenue measure approved March 22, 1933, beverages which contained not more than 3.2 per cent of alcohol by weight were exempted from provisions of the National Prohibition Act.[42]

The joint resolution proposing repeal of national prohibition was passed by Congress in March, 1933.[43] With ratification by the 36th state on December 3, 1933, the new amendment was certified as effective by the acting Secretary of State.[44] However, restrictive state constitutional and statutory provisions remained in force.

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40 Enforcement of Prohibition Laws of the United States, Report of National Commission on Law Enforcement and Observance. (Wash.: Gov't. Printing Office, 1931).

41 Ibid., p. 17.

42 48 Stat. 16 (1933).

43 47 Stat. 1625.

44 E. S. Brown, Ratification of the Twenty-first Amendment to the Constitution of the United States (Ann Arbor: University of Michigan Press, 1938) p. 5.

Anti-prohibition sentiment in Texas had reached strong proportions by 1932, when the Democratic Party platform called for repeal of the 18th Amendment and "immediate modification" of national prohibition to permit sale of "beer and other beverages of such alcoholic content as is permissible under the (federal) Constitution."[45]

The Legislature submitted the question of legalizing 3.2 beer in the 1933 election, and it was approved 317,340 to 186,312. The repeal issue came to a vote in 1935, and results of the election ended 16 years of prohibition in Texas, effective August 24 of that year.

Beer Regulation -- 1933 - 1935

When Texas voters legalized beer in the 1933 election, the Legislature had already provided a regulatory and tax act, conditioned upon adoption of the amendment.[46]

For licensing, beer manufacturers and distributors were divided into four classes, and graduated rates from $50 to $500 were provided. Licenses were issued and fees collected on a county level, with county officials compensated upon a fee basis. Both counties and cities were permitted to levy license fees at one-half the State rate. In addition to license fees, a tax of $1.50 per barrel was levied on beer sold, stored, or distributed in the state or imported into the state except that stored by manufacturers. The State Treasurer was made responsible for the design, printing, and sale of stamps to be affixed to each original container so as to be mutilated when the container was opened.

Revenue from both the license fees and the stamp tax were allocated one-half to the Available School Fund and one-half to the General Revenue Fund.

Creation of the Texas Liquor Control Board

Repeal of prohibition necessitated a new regulatory and tax act, and the Legislature was accordingly convened in special session on September 16, 1935. At the election which repealed state prohibition the electorate rejected by an overwhelming majority a proposed constitutional amendment authorizing Texas to create a state monopoly for the sale of alcoholic beverages, thus this system of control received no consideration. Legislative agreement was not reached until November 14, and the "Texas Liquor Control Act" became effective the following day.[47]

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45 "The Texas Prohibition Referendum," Pamphlet compiled by Texas Federation of Anti-Prohibition Clubs (1932).

46 Acts 43d Leg., R.S. 1933, ch. 116, pp. 288-304.

47 Acts 44th Leg., 2d C.S. 1935, ch. 467, p. 1795.

A new agency, the Texas Liquor Control Board, was created to administer the control measure. Composed of three members appointed by the Governor with consent of the Senate for six-year overlapping terms, the board was authorized to appoint an administrator bonded for $10,000 and paid a salary not to exceed $5,000 per year. The Board and Administrator were granted extensive powers and duties over the "manufacture, possession, sale, purchase, transportation, importation and delivery of liquor"; the issue, control, and cancellation of permits and licenses; the promulgation and enforcement of regulations; the imposition of advertising standards; and the use of tax-free alcohol for scientific, pharmaceutical, and industrial purposes. One member of the board was designated chairman by the Governor, and the board and its employees were prohibited from having any interest in the liquor business. The board was required to issue an annual report to the Governor each January. A somewhat unusual power was granted the board in that it might "enter into any and all contracts and comply with the regulations, even to the extent of partially or wholly aborgating any provisions" of the act should the United States government "provide any plan or method whereby the taxes on liquor shall be collected at the source..."

Regulation of the manufacture and sale of beer was transferred from the State Treasurer to the new board. Provisions relating to beer were also changed in some respects. Some license fees were lowered, and a temporary license permitting sale of beer at picnics, celebrations, or similar events was authorized. The licensing period was changed from a calendar year to a 12-month period running from the date of issue, and refund of license fees was prohibited except where local option elections changed an area from wet to dry. The gallonage tax on beer was lowered from $1.50 to $1.24 per barrel. Apparently as a retaliatory measure, an inspection fee of 50 cents per barrel was levied on beer stored in Texas but manufactured in a state levying a similar storage tax on Texas beer. The State Treasurer was to continue selling stamps, but provision was made for their printing under contracts let by the Board of Control. Allocation of gallonage tax revenue was changed one-fourth to the Available School Fund and three-fourths to the Old Age Assistance Fund, but all license tax revenue was earmarked for the General Revenue Fund.

Wine and Distilled Spirits

To make a distinction between the distilled spirits and beer business "permits," rather than "licenses," were provided for the manufacture, sale and distribution of distilled spirits. The sale or possession of alcoholic beverages containing more than 14 per cent alcohol by weight was prohibited on premises where malt or vinous beverages were sold for consumption in order to maintain the separation at the retail level. Liquor was defined as an alcoholic beverage containing more than 4 per cent alcohol by weight. Because the "open saloon" had been universally condemned and was prohibited under the constitutional amendment repealing state prohibition, that term was defined as a place of business where distilled intoxicants were sold by the drink or in broken or unsealed packages for consumption on the premises.

As with beer manufacture and sale, a multitude of permits provided varying privileges and limitations with fees ranging from $5 to $1,250. Application for beer licenses was made to county officials, but liquor permit applications had to be made to the board. Elaborate permit procedures designed to protect local interests and autonomy were outlined in the act. Bonds varying from $1,000 to $25,000, fixed at the discretion of the board, were required of permittees except for package stores selling wine only. Grounds for refusal, suspension, or cancellation of permits were enumerated. Pyramiding ownership of retail outlets, wholesale outlets, and manufacturing or distilling industries was prohibited, evidently in an attempt to limit the number of outlets in the state by preventing manufacturers and wholesalers from establishing retail outlets.

A "personal user" exemption permitted importation of only one quart of liquor without a permit. Possession of more than this amount in a dry area was declared prima facie evidence that it was possessed for reslae.

Since the control act was more than a tax measure, election procedures for determining an area's "wet" or "dry" status were also provided. Extensive penalties and unlawful acts were enumerated.

The first column of the following table shows the gallonage taxes imposed by the 1935 act.

Tax Rates on Distilled Spirits and Wine

	1935	1936
(a) Per gal. of alcoholic liquor	$ .80	$0.96
with minimum, per package	.05	.06
(b) Per gal. of still wine containing not over 14% alcohol by volume	.02	.10
(c) Per gal. of still wine containing between 14% and 24% alcohol by volume	.05	.20
(d) Per gal. of still wine containing more than 24% alcohol by volume	.50	.50
(e) Per gal. of natural sparkling wine	.25	.25
(f) Per gal. of artificially carbonated wine	.25	.25
(g) Per gal. of malt liquor containing more than 4% alcohol by weight	.15	.15

These taxes were payable by affixing stamps to each bottle or container by wholesalers, beer and wine wholesalers, wineries, or importers. Permittees holding liquor for out-of-state shipment were required to store such liquor separately, stamped to denote that it was intended for such disposal. No tax was required on such liquor, but a charge of 25 cents was made for each

stamp. Custody and sale of stamps were responsibilities of the Treasurer, but he exercised joint responsibility with the Board of Control for having them printed.

Revenues from both permit fees and stamp sales were divided one-fourth to the Available School Fund and three-fourths to the Old Age Assistance Fund.

Changes in Earmarking

In a special legislative session called in 1936 to establish a state welfare program, the tax rates on distilled spirits and wine were increased as indicated in the above table and license and permit fees were allotted to the Old Age Assistance Fund.[48] Penalties for possession of untaxed liquor were also increased, apparently in an effort to reduce liquor act violations, which posed a considerable problem in immediate post-prohibition days.

Wholesale Revision

By January 1, 1937, the Liquor Control Act had been in effect thirteen and one-half months, and its operation had revealed several inadequacies. Accordingly, in his message to the Legislature on January 28, 1937, Governor Allred made several suggestions for the improvement of the Liquor Control Act.[49] Measures dealing with liquor control and taxation were passed by two of the three sessions of the Legislature held that year.

In re-writing the regulatory act to include distilled spirits after the repeal of state prohibition the Legislature in 1935 inadvertently repealed the statute permitting the issue of search warrants in cases of liquor control violations. This inadvertence caused the Court of Criminal Appeals to observe that no authority existed for anyone to issue these search warrants, "no matter how flagrant the offense or great the necessity of such search."[50] The Legislature corrected this omission early in the session.[51]

Liquor

A completely revised Liquor Control Act was also passed incorporating many of the changes recommended by the Governor.[52] Instead of adopting the suggestion that the board be reorganized to provide for three full-time members with salaries of $5,000 annually, the legislature raised the salary of the administrator from $5,000 to $6,000. It also provided for modification or suspension of board rules by district courts pending trial. A new section was added making it compulsory for the board or administrator to hold a hearing to

48 Acts 44th Leg., 3d C.S. 1936, ch. 495, sec. 2, p. 2052.

49 Legislative Messages of Hon. James V. Allred, Governor of Texas, 1935-1939, pp. 146-149.

50 Greenway et. al. v. State, 101 SW (2d) 569, (1937), p. 570.

51 Acts , 45th Leg., RS, 1937, ch. 32, p. 43.

52 Acts, 45th Leg., RS, 1937, ch. 448, art. I, pp. 1054-1094.

determine whether any permit should be canceled or suspended upon petition of any mayor, chief of police, city marshall, city attorney, county judge, county sheriff, county attorney, or district attorney supported by the sworn statement of at least one credible person. The powers and duties of both the board and the administrator were further broadened and strengthened, and some changes were made in provisions governing permits.

Two additional steps were taken to supplement the new regulations permitting searches and seizures. Acceptance of a license or permit under the act was declared to constitute an agreement that any representative or agent of the board or any peace officer might enter the licensed premises for enforcement of the act. To assure more effective enforcement, the board was authorized to commission inspectors as needed, and the Attorney General was empowered to appoint as many as six assistant Attorneys General. Their office space, salaries, and stenographers were to be furnished by the board.

The Governor called attention to the necessity for segregating the liquor industry from the beer business, especially at the retail level, and the Legislature, throughout the new statute, added provisions designed to achieve this end. Other changes were made in the course of the general revision. For the first time, records were required of all permittees. "First sale," "retail sale," and "wholesale sale" were defined. The provisions permitting individuals to import one quart of liquor for personal use was altered to require that tax be paid and stamp affixed. Printing of stamps was made the joint duty of the Liquor Control Board and the Board of Control.

The net proceeds from all sales of confiscated alcoholic beverages were appropriated to the board. In addition, a revolving fund of $50,000 from revenues derived under the act was appropriated "in addition to any appropriation which may be made." No change was made in the allocation of receipts from liquor stamp sales and permits.

Beer

Regulations governing beer sales and licenses were also largely rewritten.[53] Graduated rates ranging from $500 to $50,000 were prescribed for manufacturers of beer according to the number of establishments. The first "personal user" importation of beer, not to exceed 24 bottles of 12 ounces or less or the equivalent in containers of other sizes, was authorized.

Final authority for the licensing of beer manufacturers and distributors was transferred from county officials to the Liquor Control Board. Applicants desiring licenses to manufacture, distribute, or sell beer were required to make application to the county judge, who held a public hearing. The

[53] Ibid., art. II, pp. 1095-1118.

applicant was subjected to a $5 fee for county use at the time of hearing. If application was approved, payment of fees was made to the county assessor-collector, but licenses were to be issued by the board. The board was empowered to refuse the applications, and refund was authorized in this event. Annual applications for renewal of licenses were to be made to the county assessor-collector, and payment of a $2 fee for county purposes was required. Refunds of license fees were authorized if local option election prevented use for the full period issued.

Distributors and manufacturers were required to record all sales daily, such records to be open for inspection of the board during "reasonable office hours." The board could also require such other records as it deemed necessary.

Beer stamps were to be provided by the State Treasurer. Importers and manufacturers were made primarily responsible for the affixation of stamps. Stamps were not required for exported beer. Refunds on stamps were authorized conditioned upon the payment of a $5 fee by the licensee desiring refund.

Structural Defects Require Rewrite

The new Liquor Control Act was hardly passed before it had to be revised for the second time by a called session which convened only a few days later.[54] Errors in the enrolled bill included incorrect cross references to numbered sections, superfluous wording, duplicating penalties, and ambiguous terminology in statements of issues to be submitted at local option elections.

Other changes were also made. Applications were required to be notarized. Permittees' records had to be kept for inspection at least two years. Importation of beer for personal use was limited to "tax paid" beer. Less significant improvements were made in wording and phraseology.

Not all discrepancies were resolved, however, for a case in October, 1937, was decided upon the basis of conflicting penalties.[55] The violation being prosecuted concerned an employee of a retail beer license holder who admitted the possession of liquor on the premises. Dismissing the offender because of inability to determine the applicable penalty, the Court of Criminal Appeals in 1938 directed attention of the Legislature to the discrepancy "in order that same may be corrected if such correction be deemed advisable." The Legislature took no action until 1943, when a general overhaul of the act was accomplished.

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[54] Acts 45th Leg., 1st C.S. 1937, ch. 13, pp. 1760-1773.

[55] Moran v. State, Tex. Civ. App., 122 S.W. 2d, 318 (1938).

Rates Increased in 1941

The 1937 act remained in effect until 1943 except for some minor changes. The following increased rates became effective in 1941:

Distilled spirits per gal.	1.28
with minimum	.08
Vinous liquor containing not more than 14% alcohol by volume per gal.	.10
Vinous liquor containing more than 14% but not more than 24% alcohol by volume, per gal.	.20
Vinous liquor containing more than 24% alcohol by volume, per gal.	.50
Artificially carbonated and natural sparkling vinous liquor, per gal.	.25
Malt liquor containing more than 14% alcohol by weight, per gal.	.15 [56]

For the first time, a tax was levied on liquor prescriptions filled by pharmacists at 22 cents each.[57] This levy considerably reduced the number of liquor prescriptions issued. On October, 1941, the Liquor Control Board reported that the number of liquor prescriptions had dropped from 449,288 for 43,147 gallons in August, 1940, to 3,592 for 445 gallons in August, 1941.[58]

A two-per-cent discount was authorized on sales of liquor stamps when purchased in lots of $500 or more. Allocation of three-fourths of the liquor stamp tax revenue was changed from the Old Age Assistance to the Omnibus Tax Clearance Fund created by that Legislature. The remaining one-fourth continued to go into the Available School Fund. Allocation of permit and license revenue was not changed, remaining earmarked for the Old Age Assistance Fund. The gallonage tax on beer was not altered and continued to be allotted one-fourth to the Available School Fund and three-fourths to the Old Age Assistance Fund.

First Liquor Control Board Audit: 1942

The first audit of the affairs of the Texas Liquor Control Board was issued in 1943. Covering the period 1936-1942, this audit acknowledged that enforcement had "been quite successful."[59] At the same time, there was some

56 Acts 47th Leg., R.S. 1941, ch. 184, art. VII, pp. 286-288.

57 Ibid., art. IX, pp. 291, ff.

58 "Texas Liquor Control Board Review," vol. 5, no. 8 (October 1941), p. 2.

59 "Audit Report and Personnel Survey, Texas Liquor Control Board, December 31, 1942," State Auditor, 1943, p. 27.

discussion of indistinct lines of divisional authority in the board's organization, with major criticism directed toward use of the Confiscated Liquor Fund and travel expenses.

Second Major Revision

Following publication of the Auditor's Report, several changes in the Liquor Control Act were made.[60] Because the handling and disposition of confiscated liquors had proved one of the most difficult problems, that subject received considerable attention. The procedures for seizing illicit beverages and alcoholic beverages declared a nuisance by the act, for having the illicit or nuisance nature determined by the courts, for paying costs of the proceedings and liens, and for disposing of such beverages were specifically detailed.

Other significant changes in the act included an overhaul of the regulations governing local option elections and their initiation, a strengthening of the powers of the board (including the power to standardize the size of containers in which liquors were sold), and a broadening of grounds for refusal, suspension, or cancellation of permits. The conflict in penalties called to the attention of the Legislature by the Court of Civil Appeals in 1938 was reconciled.

Two new types of permits were also provided apparently designed to further control importation of alcoholic beverages.[61] Concerning beer, the Act further strengthened provisions governing advertising, permissible interest of wholesalers and manufacturers in retail outlets, and the powers of the Board.

At the same time the allocation of alcoholic beverage tax revenue was changed.[62] Generally, revenues formerly earmarked for the Old Age Assistance Fund were switched to the Clearance Fund, from which revenues are transferred to other funds including that for old age assistance.

The departmental appropriation placed some restrictions upon the use of the Confiscated Liquor Fund. Appropriations as itemized in the bill were declared to be "the sole and only appropriations made to the Texas Liquor Control Board" and were to be paid first out of the Confiscated Liquor Fund until that fund was exhausted and then from the sales of distilled spirits, wine and beer stamps proportionately.[63]

The Legislature in 1945 required peace officers to make inventories of confiscated liquors and tightened board control of these beverages.

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60 Acts, 48th Leg., R.S. 1943, ch. 325, pp. 509-541.

61 *Ibid.*, Sec. 14, pp. 523-525.

62 *Ibid.*, Sec. 25-A, pp. 537-538; Sec. 25-B, p. 538, and Sec. 23, pp. 534-535.

63 *Ibid.*, ch. 400, sec. 1, p. 965.

The Legislature also relaxed restriction on use of the Confiscated Liquor Fund to permit use of 20 per cent of the receipts from sales of confiscated liquor for "expenses of purchasing and accumulating evidence as to violations" and "expenses incurred in assembling, storage, transportation, sale and accounting for such confiscated liquor and property." [64] In the 1947 audit report, the administrator was quoted as saying, "I believe the Texas Liquor Control Act should be rewritten in its entirety." His reason was that the correction of defects through constant amendment "resulted in a patchwork affair." He recommended chronological treatment of subjects and simplification. [65]

The auditor also noted that few sales were made of vehicles confiscated in connection with illegal activity. Such sales were left to the discretion of the courts, the Board having no authority to conduct them. Vehicles were seldom sold, the Auditor said, "since agreements can be approved (by the Judges) whereby the defendant pleads guilty and pays a large fine instead."

Elaboration of Detail

No action was taken in 1947, but the Liquor Control Act was considerably lengthened in 1949. Definitions were added, grounds for refusal of permits broadened, some 18 new bases for suspension or cancellation of licenses provided, and privileges granted to permit holders made more concise. A new $1 permit was provided for physicians. Restrictions on holding various types of permits simultaneously were spelled out minutely and unlawful acts further enumerated. [66]

The percentage of the confiscated Liquor Fund which might be used by the board was increased from 20 to 35 per cent, and any balance remaining at the end of a fiscal year was to remain in the fund subject to further appropriation. For the first time, a penalty was provided for peace officers who failed to file reports of confiscated liquor with the board.

The Auditor's 1947 statement that the board had no authority to sell confiscated automobiles or vehicles evidently produced a change in the law. Such vehicles plus all equipment involved in violations of the act were made subject to board disposition except that the board was permitted to retain for its own use any confiscated property except alcoholic beverages. [67]

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64 Acts, 49th Leg. RS, 1945, ch. 95, p. 145.

65 "Audit Report, Texas Liquor Control Board, January 1, 1946, to September 30, 1947," State Auditor (Austin, Texas), p. 30.

66 Acts 51st Leg., R.S. 1949, ch. 543, pp. 1011-1032.

67 Ibid., p. 1034.

Provision was also made for an assistant administrator, with the same qualifications, bond, powers, and duties granted the administrator; his compensation was not specified, but the appropriation bill limited his salary to $5,952. [68]

Revisions were also made in beer licensing and regulations. The power to issue temporary licenses was taken from the county assessors and collectors and given to the board, and revenue from these licenses was earmarked for its use. [69]

Change in Method of Taxing Beer

Effective October 1, 1949, the method of paying beer excise taxes was changed from use of stamps to collection from manufacturers and importers. [70] Importers were required to secure a license for $5. Reports and records were provided for enforcement purposes, and taxes became due the 15th of each month for the preceding month. The gallonage rate of $1.24 per barrel was not changed.

Temporary Rate Increase

All taxes on distilled spirits and beer were raised 10 per cent in 1950. These rates were to be in effect from March 1, 1950, to September 1, 1951. [71] Revenue from this increase was earmarked for the State Hospital Fund created by the act. Although the tax on prescriptions at 22 cents each was not increased in this act, proceeds from this tax were distributed as were revenues from other rates which were increased.

Recent Changes

The 52nd Legislature in 1951 enacted five measures concerning intoxicating beverages. [72] One restricted beer sales to cash transactions, one further regulated the number and type of permits any one person might hold, one prescribed additional privileges and duties for the holders of Wine Only Package Store Permits, one required approval by the Liquor Control Board of contracts for sale or delivery of liquor over agreed periods of time, and one permitted the Liquor Control Board to prescribe rules and regulations for the collection of

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68 Ibid., ch. 615, Sec. 1, p. 1283.

69 Ibid., ch. 543, p. 1041.

70 Ibid., pp. 1051-1053.

71 Acts 51st Leg., 1st C.S. 1950, ch. 2, art. VII, p. 18, and art. XVI, p. 28.

72 Acts 52d Leg., R.S. 1951, ch. 22, pp. 28,29; ch. 66, pp. 110-112; ch. 157, pp. 272.-273; ch. 231, p. 366; ch. 234, p. 370.

taxes on wine, including "the right to determine whether or not stamps evidencing the payment of such tax shall be affixed to the containers."

The reason for the latter act was that the board had already "devised and is now using under a temporary law a method of collecting the tax on wine which is satisfactory, and which does not require the affixing of stamps to the containers. . . ."

The 10-per-cent temporary tax increase on intoxicating liquors enacted in 1950 was made permanent with slight changes.[73]

Conclusion

The taxation of alcoholic beverages has been part of the Texas revenue system since its declaration of independence from Mexico in 1836. Until 1933, licensing was the chief method employed. With the adoption of beer gallonage taxes at that date, alcoholic beverage revenues began to figure more prominently in state finances. These taxes at present account for some $17 million of revenue annually. Until state-wide control became a primary aim of state policy, administration was generally entrusted to established state agencies. With prohibition repeal, both control and tax collection were centralized in the Liquor Control Board and constant legislative attention has been required during the past seventeen years to perfect both control and tax provisions. Some problems still remain to be dealt with, but the larger difficulties have been, in the main, surmounted.

73 Ibid., ch. 402, sec. VIII, p. 704 and sec. XX, p. 719.

SECTION 2 - ORGANIZATIONAL FORM

Taxes on alcoholic beverages in Texas are of two types. Besides excise taxes graduated according to alcoholic content and measured in gallons or barrels, permits or licenses and fees are required of persons, firms, associations, and corporations engaged in any phase of the alcoholic beverage business. Because the industry has many facets, varied procedures and administrative practices are necessary. It is also important to remember that the Liquor Control Act is concerned not only with tax collection but also with regulation of the sale and use of alcoholic beverages, including the enforcement of local option. Thus there are no distinct dividing lines between the tax administration function and the regulatory function. In addition, many agencies and state officials are involved in the administration of the control act. Since tax collection and enforcement is the subject of this discussion, other aspects of liquor control will be minimized or omitted.

Texas Liquor Control Board

Primary responsibility for administration of the alcoholic beverages tax rests with the three-member Liquor Control Board and its administrator. The Governor's appointees to the board must have been residents of Texas for at least five years, must have no connections with the liquor business, and receive actual expenses while performing their duties and $10 per diem for not more than 60 days in any year. The Liquor Control Act authorizes the board to select an administrator to serve at its discretion with a salary of $6,000 per year and under bond for $10,000. This salary limitation, however, has apparently been superseded by appropriation acts since 1949. For the years beginning September 1, 1949, and September 1, 1950, appropriation for the administrator's salary was $7,200.[74] In 1951, the Legislature increased this amount to $8,004 annually for the 1952 and 1953 fiscal years.[75] The administrator selects the assistant administrator to act in his absence or inability. He must have the same qualifications required of the administrator and post the same bond,[76] and is currently paid $6,600 per year.[77]

Throughout the control act, powers, functions, and duties are assigned to the board, to the administrator, and to both concurrently. The board is required to specify the duties of the administrator, and if concurrent duties and powers are imposed, the board may delegate such powers to the administrator. Orders rendered by the administrator in "matters upon which he has been empowered to act shall not be subject to change, review,

74 Acts 51st Leg., R.S. 1949, ch. 615, sec. 1, p. 1283.
75 Acts 52d Leg., R.S. 1951, ch. 499, art. III, sec. 1, p. 1380.
76 Tex. Pen. Code Ann. (Vernon, 1951) art 666-5a.
77 Acts 52d Leg., R.S. 1951, ch. 499, art. III, sec. 1, p. 1380.

or decision by the board." All concurrent powers not specifically delegated by the board to the administrator are retained by it, and, of course, its actions in these areas are not "subject to change, review, or revision by the administrator."[78]

Among the responsibilities assigned to the board are these:

(a) To supervise, inspect, and regulate every phase of the business of manufacturing, importation, exportation, transportation, storage, sale, distribution, possession for the purpose of sale and possession of all alcoholic beverages. . .

(b) . . . to prescribe all necessary rules and regulations. . .

(c) . . . to require filing of reports. . .

(d) . . . to supervise and regulate all licensees and permittees. . .

(e) . . . to grant, refuse, suspend, or cancel permits or licenses . . .

(f) . . . to investigate and aid in prosecution of violations of this Act and to make seizures of alcoholic beverages [utilized] in contravention [of this Act] . . .

(g) [to regulate labeling, advertising, quality, purity, identity, sanitation, and size of containers for alcoholic beverages]

(h) to license, regulate, and control the use of alcohol and liquor for scientific, pharmaceutical, and industrial purposes. . .

(i) In the event the United States Government shall provide any plan or method whereby the taxes on liquor shall be collected at the source, . . . to enter into any and all contracts and comply with regulations, even to the extent of partially or wholly abrogating any provisions [of this Act and] to . . . receive the portion [of receipts] allocated to the State of Texas, and to distribute the same as in this Act is provided.

(j) [and] to exercise all other powers, duties, and functions conferred by this Act, and all powers incidental, convenient, or necessary [to the administration of this Act].[79]

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78 Tex. Pen. Code (Vernon, 1948) art. 666-12a.

79 Ibid., art. 666-6.

The only duties specifically imposed upon the administrator by the act make him "manager, secretary, and custodian of all records" unless otherwise ordered by the board, require that he devote his full time to that office, and permit him to choose the assistant administrator.[80] Among powers granted concurrently to the board and the administrator are those of appointing employees and of fixing their duties and salaries.

The Liquor Control Board has granted these powers exclusively to the administrator; in addition the authority to grant, refuse, cancel and suspend permits and licenses; to conduct hearings on permits and licenses and to designate board members or representatives to hold such hearings; to authenticate all records, notices, orders, publications, rules, documents, and reports in possession of the board; to investigate matters in connection with alleged violations by out-of-state wholesalers, brewers, distillers, manufacturers, and agents, wineries, and their employees; to make recommendations as to pleas of guilty;[81] and to execute the affidavit required on payrolls stating that persons listed on the roll actually performed the duties for which they are being paid.[82] Additional duties and powers have been conferred upon the administrator in connection with several of the rules and regulations adopted by the board.

The board has made extensive use of its power to promulgate rules and regulations, current copies of which are available to interested persons and license and permit holders. Altogether, from 50 to 75 such regulations dealing with all phases of liquor control are presently in force. Most of them are dated between 1937 and 1943. A rule or regulation which may result in the imposition of a penalty can be adopted only after notice and hearing.

For administrative purposes, the Liquor Control Board is separated into four divisions--accounting, auditing, executive, and enforcement--all of which perform functions relating directly to administration of alcoholic beverage taxes. On December 31, 1950, 250 persons were employed by the board as indicated in Chart AB-1. Employees having most to do with tax administration are concentrated in the License and Permit Section of the Accounting Division, the Auditing Division, the Chief Examiner's Office in the Executive Division, and the Enforcement Division.

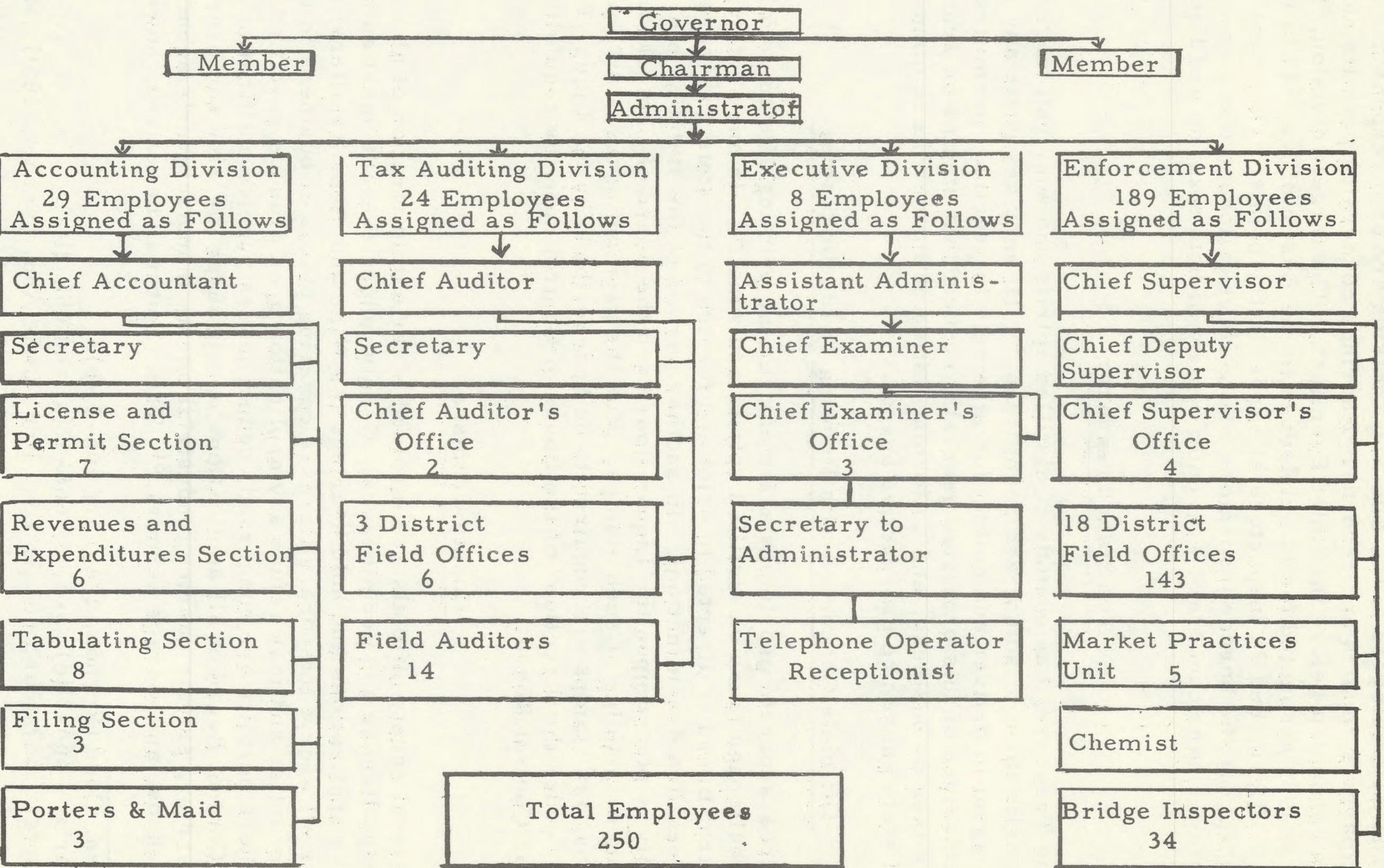
The License and Permit Section consisting of seven employees receives and processes applications for all licenses and permits. The Auditing Division receives payments for beer gallonage taxes while permit fees are received and tabulated in the Revenues and Expenditures Section of the Accounting

80 Ibid., art. 666-5; Tex. Pen. Code Ann. (Vernon, 1951) art 666-5(a).

81 "Rule and Regulation No. 3-A," Texas Liquor Control Board, dated September 1, 1937.

82 "Rule and Regulation No. 3-B," Texas Liquor Control Board, dated September 18, 1939.

CHART AB-1, TEXAS LIQUOR CONTROL BOARD, DECEMBER 31, 1950



Division. The 24 employees of the Auditing Division are also responsible for audits of taxpayer's reports and records. Hearings concerning permits and licenses are conducted before the Chief Examiner. The largest division, Enforcement, in 1950 accounted for 12 employees in the Austin office, 143 in 18 district field offices, and 34 inspectors at border entry points. These employees, except for the border inspectors who collect gallonage taxes on imported beverages, are concerned with enforcement of both taxation and liquor control.

The State Treasurer

The Treasurer has custody of distilled spirits and wine gallonage tax stamps and sells them to authorized permittees.[83] He may designate any state bank as his agent to deliver and collect for stamps. In practice, permittees availing themselves of this provision generally request that stamps be sent to banks where they do business, and no formal listing of such banks is maintained. All state banks are prospective agents.

Officials Concerned with Printing of Liquor Stamps

Three separate provisions are made for the printing of stamps for the payment of gallonage taxes on distilled spirits and wine.[84] In one section, the Liquor Control Board is directed to print and furnish to the State Treasurer stamps in specified denominations. In another portion of the statute, joint responsibility is placed upon the Liquor Board and the Board of Control for the engraving or printing of such stamps. For the payment of taxes on liquor prescriptions, tax stamps are required to be "prescribed" by the Liquor Board and printed "under the direction" of the Board of Control upon the requisition of the Liquor Control Board.

County Officials

Several county officials are involved in the administration of alcoholic beverage license and permit taxes. County judges exercise most authority.[85] They receive applications and hold hearings for Wine and Beer Retailers' Permits and for all except temporary licenses covering places of business in their respective counties and may refuse any application upon grounds specified in the act. Where permits are concerned, county judges receive notification from the Liquor Control Board of all applications except those for wine and beer retailer, carrier, private carrier, industrial agent, manufacturer's agent, bonded warehouse and storage permits.[86] This right may be waived, however,

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83 Tex. Pen. Code (Vernon, 1948) art. 666-45(b).

84 Ibid., arts., 666-21(d), sec. 5, 666-42(a) and 666-21(a).

85 Ibid., arts. 667-6 and 667-7; Tex. Pen. Code Ann. (Vernon, 1951) art. 667-5.

86 Tex. Pen. Code (Vernon, 1948) art. 666-15c.

and some judges have been reluctant to either accept or waive notice because of the partisan disputes which sometimes arise concerning granting of permits. Because the control act requires that one or the other action be taken and in the event notice sent by the Liquor Control Board is returned unopened, it is mailed in a plain envelope, without return address, registered mail, return receipt requested. Thus the judge accepts notice without being initially aware that he is doing so.

County tax assessor-collectors collect Wine and Beer Retailer's Permit fees and all except temporary license fees. They also certify to the board that applications are approved and fees paid. Should the board refuse an application approved by the county judge, the assessor-collector refunds the fee. License renewals are made in a similar manner. Assessor-collectors are required to make statements of taxes collected at intervals and in the manner prescribed by the board.[87] They also collect a $2 fee for county purposes from each applicant filing renewal application.

County clerks must post notice on the courthouse door of forthcoming license or permit hearings and collect a $5 fee for county use at the time of hearing on each original application. In addition, county clerks are required to furnish the board or its representatives, on demand, certified copies of judgments of conviction or any information against persons convicted of violating the Liquor Control Act. Each clerk must also certify to the board results of local option elections. On August 1 each year, he must report to the board the exact wet or dry status of cities, towns, justice precincts, and the county as a whole.[88] He must also certify, for each application for permit or license, that the address for which the license is sought is in an area where the sale of alcoholic beverages is permitted.[89] City clerks must do the same for cities as to prohibitions in city charters or ordinances.

A mayor, chief of police, city marshall, city attorney, county judge, sheriff, county attorney, or district attorney of a county where a permittee's place of business is located may, by a simple request, compel the board or administrator to hold a hearing to determine whether a permit or license should be canceled or suspended.[90] Such request must be supported by the sworn statement of at least one additional credible person. Recommendations of these officials are to be given "due consideration" before granting or refusing any permit. By exercising their rights, county and city officials can influence the granting, cancellation, or suspension of permits and thereby affect tax collections.

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87 Ibid., art. 667-11.

88 Tex. Pen. Code Ann. (Vernon, 1951) art. 666-41a.

89 Ibid., art. 666-54.

90 Ibid., art. 667-20; Tex. Pen. Code (Vernon, 1948) art. 666-12a.

Enforcement Agencies

As with license and permit procedures, several agencies and officials are concerned with enforcement of the Liquor Control Act. The Liquor Control Board is the chief enforcement authority. Because its efforts are directed toward both enforcement of local option (liquor control) and tax collection, a division of these two functions is impossible. The board of the administrator is authorized to commission as many inspectors as deemed necessary,[91] but this grant of authority has little meaning in fact because a practical limit on the number is imposed by appropriation acts. These inspectors are supervised by the Enforcement Division of the Board and exercise all the powers of police officers, coextensive with the borders of the state. The Tax Auditing Division of the Board, which audits taxpayers' reports and records to verify taxes paid and the Chief Examiner's Office which conducts hearings for cancellation or suspension of permits also contribute to enforcement.

Peace officers may enter licensed premises to conduct investigations or inspections or perform any duties imposed by the act,[92] and are authorized to seize illicit beverages.[93] Because local officials are largely concerned with the preservation of peace and order rather than with tax enforcement, their activity may be reflected more in effective enforcement of regulation than in higher tax collections. These officers of the city, county, and state are, nevertheless especially charged with enforcement of the act.[94]

Officials Involved in Litigation

The Attorney General is authorized to appoint as many as six assistant Attorneys General, depending upon need as determined by the board, to prosecute actions to which the board is a party.[95] The statute requires that the board pay their salaries and provide them with stenographers and office space. This authorization was apparently very necessary early in the enforcement of the Liquor Control Act when court actions were numerous. At present, assistant attorneys general are requested as needed. During the calendar year 1950, five assistants were utilized in the prosecution of 30 cases--19 contempt actions, 5 temporary injunctions, 1 permanent injunction, and 5 forfeitures.[96] Their salaries were paid by the Attorney General, but all expenses incident to those suits, including travel and meals, were paid by the board.

The Attorney General must also institute proceedings for forfeiture of charter against any corporation, other than a carrier doing business in the

91 Tex. Pen. Code (Vernon, 1948) art. 666-7b.

92 Ibid., art. 666-13 (d).

93 Tex. Pen. Code Ann. (Vernon, 1951) art. 666-42.

94 Tex. Pen. Code (Vernon, 1948) art. 666-31.

95 Ibid., art. 667-7 (c).

96 "Sixteenth Annual Report of Texas Liquor Control Board," 1950, p. 31.

state when notified of its violation of the act.[97] Amenability of foreign concerns to suits in the state is assured by providing that manufacturers, distributors, and persons shipping beer into the state must file with the Secretary of State the names of their agents upon whom service may be had. Should they fail to do so, service may be had upon the Secretary of State, who must send the citation to out-of-state manufacturers, distributors, and persons by registered mail, return receipt requested.[98] This procedure is occasionally utilized.

Any magistrate upon affidavit of a credible person may issue a search warrant for premises where the act is being violated, except that two affidavits are required if a residence is involved.[99] County attorneys, district attorneys, and the Attorney General must institute proceedings to restrain persons from threatened or further violations of the act if informed by affidavit of a credible person that such violation has occurred or is about to occur or that a license has been wrongfully issued. The district judge having jurisdiction may issue temporary restraining orders without hearing and grant injunctions, upon notice and hearing. The district court clerk must notify the county judge of the county where the license was issued and the board of such judgments.[100]

County attorneys, district attorneys, and the Attorney General must institute suits for forfeiture of seized beverages and property when notified of such seizure. Although sheriffs, constables, and the board are authorized to sell confiscated property, liquor sales are made only by the board.

Decisions of the county court or the board may be appealed to district courts which may modify orders, rulings, or decisions of the board refusing, canceling, or suspending permits or licenses pending trial on the merits. However, the board's decisions may not be altered pending appeal.[101]

One measure of the participation of local attorneys in enforcement of the act is the number of violators prosecuted. In calendar year 1950, 4,376 criminal cases were filed by county and district attorneys.[102] A total of 3,557 convictions were secured and $562,635 collected in fines. Evidence upon which these cases were tried was accumulated largely by enforcement personnel of the board.

Summary

In general, administration of alcoholic beverage taxes is centralized in the Liquor Control Board, created primarily for regulation. Other state

97 Tex. Pen. Code (Vernon, 1948), art. 666-18.
98 Ibid., art. 667-12.
99 Ibid., art. 666-20.
100 Ibid., art. 667-27.
101 Tex. Pen. Code (Vernon, 1948), art. 666-14.
102 "Sixteenth Annual Report, Texas Liquor Control Board, 1950," p. 33.

agencies, especially the Treasurer and Attorney General, and local officials, chiefly county judges, are also involved. The nature of the board's tasks, taxation and regulation, probably requires the assistance and integrated operation of these varied agencies in order that the state's policy aims may be realized.

SECTION 3 - ASSESSMENT

Alcoholic beverage taxes in Texas consist of four separate levies. License and permit fees are imposed on all persons engaged in the alcoholic beverage business and gallonage taxes are levied on distilled spirits and beer. Although licenses and permits are essentially the same and perhaps designed primarily for regulatory purposes, a distinction is made between them which facilitates tax administration by assuring control and coverage of legitimate operators. Where regulation is intended, the general theory is that license or permit fees should be so fixed as to produce only enough revenue to cover the cost of regulating the affected business. Operating expenses of the Liquor Control Board were $1, 078, 575 in 1950, while alcoholic beverage license and permit fees totaled $1, 387, 460. Thus these receipts, in a sense, compensate the State for the costs of regulation and administration, while gallonage taxes produce revenue to finance other State programs. In general, permits are required for persons engaged in any phase of the liquor or wine business, while licenses are prescribed for those manufacturing, distributing, or retailing beer, and the procedure for granting permits differs from that for issuing licenses. Assessment methods for distilled spirits gallonage taxes also vary considerably from those for beer.

In the following discussion, an attempt has been made to deal separately with these four levies. However, the present organizational arrangement of the Liquor Control Act often prevents separation.

1. INTOXICATING LIQUORS

Distilled Spirits Permits

The sale, manufacture, distribution and importation of alcoholic beverages containing more than 4 per cent alcohol by weight can be engaged in only with the express permission of the state granted in the form of a "permit." The various permits, fees, and bonds required are given in Table AB-1, as well as the number issued in 1950. The large number of permit types, 22 in all, would appear to present administrative problems. Package stores account for more than half the permits issued, and several types represent exceedingly small fractions of the total. Some types, too, have been adopted to serve control purposes. A division between wholesalers and retailers is established by defining a retail sale as the sale of three gallons or less of distilled spirits.[103] Sales of greater quantities constitute wholesale transactions. Wine and Beer Retailers' Permits, except those issued for railway dining, buffet, and club cars, are treated as licenses. Because of the differences between permits and licenses, they are discussed in connection with licensing procedures.

103 Tex. Pen. Code (Vernon, 1948), art. 666-23a, (6) and (7).

TABLE AB-1
Permit Tax Rates, Bonds and Number Issued

Type of Permit	Fee	Bond	No. Issued Calendar 1950
1. Brewer's	$1,000	$15,000	0
2. Distiller's	1,000	25,000	0
3. Class A Winery	50	5,000	2
4. Class B Winery	10	1,000	5
5. Rectifier's	1,000	10,000	0
6. Wholesaler's	1,250	10,000	55
7. Class B Wholesaler's	200	5,000	27
8. Package Store			3,656
Population of 25,000 or less	125	1,000	
" " 25,001 to 75,000	175	1,000	
" " 75,001 or more	250	1,000	
Outside Cities and Towns	125	1,000	
Within 2 miles of corporate limits of incorporated city or town	Same as for city	1,000	
9. Wine Only Package Store			334
Population of 2,000 or less	5.	1,000	
" " 2,001 to 5,000	7.50	1,000	
" " 5,001 to 10,000	10.00	1,000	
" " 10,001 or more	12.50	1,000	
Outside cities and towns	5.	1,000	
Within 2 miles of corporate limits of incorporated city or town	Same as for city	1,000	
10. Agent's	5.	1,000	682
11. Industrial	10.	1,000	115
12. Carrier	5.	None	116
13. Private Carrier	5.	1,000	85
14. Local Cartage	5.	1,000	619
15. Bonded Warehouse	100.	5,000	19
16. Storage	None	1,000	25
17. Wine and Beer Retailer's for railway, dining, buffet or club car	5.	None	97
18. Wine Bottler's	$150	$5,000	9
19. Medicinal	10	1,000	6
20. Physician's	1	1,000	10
21. Non-resident Seller's	None	1,000	291
22. Manufacturer's Agent's	5	1,000	232
			6,385

SOURCE: Rates, Tex. Pen. Code, (Vernon, 1948), art. 666-15 1/2, and Tex. Pen. Code Ann. (Vernon, 1951), Art. 666-15; bonds, "Rule and Regulation Nos. 4-A, May 15, 1939, 4-A, (as amended) July 22, 1943, and 4-B, June 24, 1943, Texas Liquor Control Board; number of permits issued in 1950, "Sixteenth Annual Report of the Texas Liquor Control Board, 1950," p. 15.

Qualifications of Permittees

Besides specific qualifications, rights, and privileges attached to each type of permit, applicants must meet some general requirements.[104] They must have been residents of Texas for at least three years; corporations must be incorporated under the laws of this state and have at least 51 per cent of their stock owned by persons who meet the residence requirement and qualify as individual applicants. The stock ownership requirement does not apply if the corporation operated in Texas under a charter or permit prior to August 24, 1935. Partnerships, firms, and associations desiring licenses must be wholly composed of persons who have resided in Texas for at least three years. Exemptions from the residence and incorporation provisions are granted to applicants for Agent's, Industrial, Medicinal, and Carrier's Permits. Additional qualifications may be gathered from several other provisions of the act, especially the grounds for refusal of permits.[105]

Application for Permits

Application for permits is made directly to the Liquor Control Board.[106] Most applications must be prepared in duplicate, one copy to be filed with the board's district office and the other to be mailed to the board in Austin. District enforcement personnel make an investigation "on the spot" and report their findings prior to board approval.

Applicants for Pharmacist's, Medicinal, Brewer's, Distiller's, Winery (except Class B Winery), Wholesaler's, Class B Wholesaler's, Wine Bottler's, or Package Store Permits must publish notice of application in two consecutive issues of a newspaper having circulation in the city, town, or county where the place of business is to be located. This announcement must include the type of permit for which application is made, exact location of the place of business, names of all owners or officers, if a corporation, and the trade name of the establishment.[107] Persons who intend to conduct business under an assumed name must attach certificates of assumed name prepared by the county clerk in conformity with Texas law.[108] Notice of application for these permits must be furnished by the board to the county judge unless he waives this right in writing.

When the board receives an application, payment of the fee is detached by the Revenues and Expenditures Section and the application forwarded to the License and Permit Section where a thorough check is made to assure that the applicant has not previously violated the act. If no grounds for refusal are

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104 *Ibid.*, art. 666-18.

105 Tex. Pen. Code Ann. (Vernon, 1951), art. 666-11.

106 Tex. Pen. Code (Vernon, 1948), art. 666-15c.

107 *Ibid.*, art. 666-10.

108 "Rule and Regulation No. 33," September 18, 1939, Texas Liquor Control Board.

discovered, the enforcement district office report is favorable, and notice has been furnished the county judge, a board hearing is held. Grounds for which permits may be refused are enumerated in detail in the act, and refusal by the board to issue a permit may be appealed within 30 days to the district court in the county in which the applicant resides.[109]

Application forms contain spaces for notarizing certification of county or city clerks as to wet or dry status of the area within which permit is to be issued, affidavit of the publisher of the notice, a copy of the notice, and waiver by county judge of notice of filing application. Permits are effective for 12-month periods coinciding with the state's fiscal year, and fees are due in advance. Proportional payments are authorized when part of the fiscal year has elapsed prior to issuance of the permit. A fee must be paid and a permit obtained for each liquor outlet in the state.

Restrictions Upon Permits and Licenses

Extensive restrictions are placed upon the conduct of permittees and Licensees. One group of these restrictions is designed to prevent or restrict horizontal and vertical integration of business units in the industry. For example, no person may own an interest in more than 5 package store permits unless he held such interest prior to May 1, 1949. Any persons owning or having an interest in the business of a distiller, brewer, rectifier, wholesaler, Class B wholesaler, Class A winery, Class B winery, or wine bottler cannot own or have an interest in a retail liquor establishment.[110] Some of these restrictions appear to be aimed at establishing a marketing structure in the industry, perhaps to aid regulation of liquor traffic and consumption.

Refunds and Duplicate Permits

Permit fees are deposited in a Suspense Account in the State Treasury until the board approves the application. If the application is refused, refund is made. Refunds are also permitted if the results of a local option election prevent a permittee's conducting his business for the full year for which a fee is paid.[111] Duplicate or corrected permits may be issued when necessary.

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109 Tex. Pen. Code Ann. (Vernon, 1951) art. 666-11, and Tex. Pen. Code (Vernon, 1948), art. 666-14.

110 Acts 52d Leg., R.S. 1951, ch. 66, p. 110, and Tex. Pen. Code Ann. (Vernon, 1951), art. 666-17. The act specifies a number of such limitations.

111 Tex. Pen. Code (Vernon, 1948), art. 666-15b.

Liquor Stamp Tax

Gallonage taxes on liquor are imposed at rates as shown in Table AB-2.

Table AB-2

Distilled Spirits Tax Rates, 1951

Class of Beverage	Rate
(a) Distilled spirits, per gal.	$1.408
with minimum, per package	.088
(b) Vinous liquor containing no more than 14 per cent alcohol by volume, per gal.	.110
(c) Vinous liquor containing more than 14 per cent but no more than 24 per cent alcohol by volume, per gal.	.220
(d) Artifically carbonated and natural sparkling vinous liquor, per gal.	.275
(e) Vinous liquor containing more than 24 per cent alcohol by volume, per gal.	.550
(f) Malt liquor containing more than 4 per cent alcohol by weight, per gal.	.165
(g) Prescription tax stamps, each	.22

SOURCE: Acts 52d Leg., R.S. 1951, ch. 402, sec. VIII, p. 704, and Tex. Pen. Code (Vernon, 1948) art. 666-20a.

Responsibility for affixing and canceling stamps by which taxes are paid is placed upon "each person who makes a first sale of any liquor in this state." Stamps are required even though the liquor bears the federal liquor strip stamp or is imported from a foreign country.[112] However, unstamped liquor may be imported into or transported within the state if it is consigned to the holder of a Wholesaler's Permit.

112 Tex. Pen. Code Ann. (Vernon, 1951), art. 666-17.

Exported Distilled Spirits

Persons authorized to export distilled spirits from the state must segregate liquor intended for export in storage and stamp each package so segregated with a stamp signifying its eventual export. There is no tax on such liquor, but a charge of 25 cents per stamp is made for liquor containing more than 24 per cent alcohol. The charge is 10 cents per stamp for vinous or malt liquors containing 24 per cent alcohol or less. No limitation is placed on the size of a "package;" it may be a barrel, case, or carton.

Sworn application for permission to export must be made in triplicate to the district office of the Liquor Control Board having jurisdiction.[113] An order signed by the purchaser or a letter of authority, if the liquor is being returned to the distillery or manufacturer, must accompany the application. A representative of the board then inspects the liquor to be exported to assure that it is stamped, cancels the export stamps, and approves the application. The liquor may then be exported but may be transported only by the holder of either a Common Carrier or Private Carrier Permit. The Liquor Board representative returns one copy of the approved application to the exporter and forwards the other two to the board in Austin, accompanied by a copy of the invoice or bill of lading furnished by the shipper. Claim for refund, based upon the certified inventory, may then be made to the board in Austin.

Stamp Denominations

The statute limits stamps to the following denominations: for distilled spirits, in multiples of the rate assessed per half-pint, 1/5 gallon and 1/10 gallon; for wine in multiples of the rate assessed for each pint, 1/5 gallon and 1/10 gallon; for malt liquors containing more than 4 per cent alcohol by weight in multiples of the rate assessed for each 7 fluid ounces, 8 fluid ounces, 12 fluid ounces, and 1/5 gallon; and for cases of ale the board may authorize stamps of various denominations if the total of such stamps evidences payment of all taxes due.[114] Because it was discovered that stamps failed to adhere to malt liquor containers when they were immersed in ice and water public hearing was held by the board to consider revision of the rules requiring affixing stamps to such containers. Effective March 1, 1942, stamps were required to be affixed only to "original packages" in an aggregate amount to cover taxes on all bottles or containers so packaged.[115]

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113 "Amended Rule and Regulation No. 6A-1, As Amended," August 22, 1951, Texas Liquor Control Board.

114 Acts 52d Leg., R.S., 1951, ch. 402, sec. VIII-A, p. 705.

115 "Rule and Regulation No. 161-2," January 12, 1942, Texas Liquor Control Board.

Affixing Liquor Stamps

Liquor stamps must be affixed to each bottle "just below the neck on the side or face on which the principal label appears" unless enclosed in a metal container or wrapper which would be mutilated or damages if opened. In that case, the stamps must be affixed "near the top of such container and on the side on which appears the principal label."[116]

Wine Stamps Not Affixed to Bottles

As concerns the affixing of stamps to wine containers, the Legislature in 1951 gave the board "the right to determine whether or not stamps evidencing . . . payment . . . shall be affixed to the containers." The Legislature noted that "the Board has devised and is now using a method of collecting the tax on wine . . . which does not require the affixing of stamps to the containers . . . and . . . this power in the Board should be permanent . . ."[117] The method devised by the board was promulgated in a rule and regulation dated March 31, 1950, and resembled that adopted for malt liquor stamp taxes.[118] Instead of applying stamps to individual bottles or containers in the denominations indicated for vinous beverages, the board required that stamps evidencing payment of such taxes be affixed to each "original package" in the aggregate value of taxes due on the total number of bottles or containers so packaged. Taking cognizance of the statutory requirement that stamps be issued only in multiples of the rates assessed for specified quantities, the board has prescribed stamp denominations for original packages containing 2.4, 3, and 4 gallons. Should vinous beverages be bottled in irregular-size containers for which no corresponding stamp is prescribed, then a stamp of the next highest denomination must be affixed.

Prescription Tax Stamps

Prescription tax stamps are printed and bound in books of 100 stamps and counterparts, and are sold by the Treasurer to authorized medicinal permittees at the rate of 22 cents per stamp. At the time the prescription is filled, one part of the stamp is affixed to the prescription and the other part to the container.[119] The person affixing such stamps must cancel both parts by writing his initials on each. The stamp must be affixed to the neck of the bottle on the side on which the principal label appears, but it may not cover any other tax stamp on the bottle. The counterpart is affixed to the back of the prescription. Medicinal permittees are prohibited from purchasing more than 100 stamps for each 90-day period and may not purchase them in smaller quantities. In 1950, there were only six such permittees.

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116 "Rule & Regulation No. 16H-1," August 14, 1939, Texas Liquor Control Board.

117 Acts 52 Leg., R.S. 1951, ch. 234, p. 370.

118 "Amended Rule and Regulation No. 45, March 31, 1950, Texas Liquor Control Board.

119 "Rule & Regulation No. 16-R, May 19, 1941, Texas Liquor Control Board.

Printing and Sale of Stamps

Alcoholic beverage tax stamps are sold by the Beer and Cigarettes Tax Stamp Division of the Treasurer's office to authorized purchasers. Total sales are reported daily to the Revenues and Expenditures Section of the board and both agencies maintain daily stamp inventories. Some stamps are furnished to board inspectors at ten ports of entry--Brownsville, Del Rio, Eagle Pass, El Paso, Hidalgo, Laredo, Roma, San Antonio, Thayer, and Ysleta. In 1950, receipts at these places totaled $477,296 and were deposited temporarily in banks in El Paso and Laredo.

Consecutively numbered invoices of stamp sales are issued by the Treasurer in triplicate, one copy for his records, one to go to the Liquor Control Board, and one to accompany the stamps. At the permittee's request, the Treasurer may mail stamps to the purchaser's bank with a sight draft attached; before the permittee can get the stamps, he must sign the draft.

Credits, Discounts, and Refunds

Purchasers of stamps in lots of $500 or more are authorized a discount of two per cent of the face value of the total purchase. This discount is applied automatically by the Treasurer.[120]

Refunds for tax stamps may be made by the board before the allocation of revenue from stamp sales where stamped liquor is returned to the distiller or manufacturer.[121] Application for refund must be made to the district office having jurisdiction. A representative of the board then makes an inventory of the tax-paid liquor, mutilates the stamps, and forwards his inventory and the application to Austin, where refund is approved and warrant requested. Refunds are also given permit holders who hold tax stamps upon discontinuance of business. Should a permittee return distilled spirits to an out-of-state manufacturer or distiller, he must purchase export stamps which are inspected and mutilated by the board representative. This requirement perhaps discourages frequent returns to out-of-state concerns.

Credits on future stamp purchases are granted if it is necessary to destroy any stamped liquor because it has become unfit for sale or consumption. Unlike refunds, however, these credits may never be collected by warrant. The procedure for obtaining credit is the same as that used for refunds.

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120 Tex. Pen. Code (Vernon, 1948) art. 666-21d.

121 Ibid., art. 666-45 (d).

Exemptions

Certain beverages not intended for ordinary consumption are exempt from the liquor stamp tax. "Any minister, priest, or rabbi or religious organization" may obtain sacramental wine without payment of any "fee or tax . . ., directly or indirectly, for the exercise of this right."[122] The board is authorized to prescribe rules and regulations concerning the importation of wine for sacramental purposes. Effective May 19, 1941, persons desiring to import tax-free wine for sacramental purposes were required to apply to the board for permission to do so, giving the types, quantities, and alcoholic content and the prospective seller of the desired beverage.[123] In addition, the seller is required to obtain an affidavit from the minister, priest, rabbi, or other authorized head of a religious organization to the effect that the wine will be used for sacramental purposes.

Holders of Industrial Permits are authorized to import, transport, or use tax-free alcohol for manufacturing "denatured alcohol; patent, proprietory, medicinal, pharmaceutical, antiseptic, and toilet preparations; flavoring extracts, syrups, condiments, and food products; and scientific, chemical, mechanical, industrial, and medicinal products."[124] In addition, druggists and pharmacists, state institutions, colleges and universities, and hospitals and sanatoria may use tax-free alcohol for their respective purposes.[125] Wholesalers may import alcohol to be sold for these purposes without affixing stamps. Tax-free wine may also be purchased in bulk lots of not less than five gallons by holders of Industrial Permits for compounding medicines and food products.[126]

"Personal User" Importation

An individual may bring into the State for his personal use no more than one-quart of liquor, but tax stamps must be affixed.[127] It must be emphasized that this is not a tax exemption in the usual sense but a control measure corollary to the provision that possession of more than one quart of distilled spirits in dry territory is prima facie evidence that it is possessed for resale.

Some conflict has arisen between this import limitation and that imposed by the federal government. Under the Tariff Act of 1930, as amended, residents of the United States are permitted to import tax-free distilled spirits, wine, and malt beverages in an aggregate amount not to exceed one wine gallon.[128]

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122 Ibid., art. 666-15a.

123 "Rule & Regulation No. 14A-1," May 19, 1941, Texas Liquor Control Board.

124 Tex. Pen. Code Ann. (Vernon, 1951), art. 666-15 (10).

125 "Rule & Regulation No. 7A-1," August 14, 1939, Texas Liquor Control Board.

126 "Rule & Regulation No. 7B," September 18, 1939, Texas Liquor Control Board.

127 Tex. Pen. Code (Vernon, 1948), art. 666-23a, (2) and (4).

128 U.S.C.A. (Pocket Part, 1950), tit. 19, sec. 1201, par. 1798 and 19 CFR (1949 ed.) sec. 10.17 (b) and (d).

Residents of other states are often not aware of the Texas limitation and assume that they may bring in one gallon of foreign liquor. However, both state and federal inspectors in Texas enforce the state law, allowing only one quart to be imported and requiring that the tax be paid on it. Liquor in excess of a quart is confiscated and sold by the Liquor Control Board. No federal tax is collected on the quart unless the total value of imported articles exceeds the permitted amount. Though producing no special difficulties, this difference often produces considerable ill-will.

II. MALT LIQUORS

Beer Licenses

Licenses are required of all persons, firms, or corporations engaged in any aspect of the beer business, as contrasted with permits for persons engaged in the manufacture, sale, or distribution of distilled spirits (liquor and wine). Licenses and fees are prescribed as indicated in Table AB-3.

Table AB-3

License Tax Rates

Type	Fees	No. Issued calendar year, 1950
1. Manufacturers		8
1st establishment	$ 500	
2d establishment	10,000	
3d, 4th, 5th establishments	25,000	
Each establishment in excess of 5	50,000	
2. General Distributor	200	252
3. Local Distributor	50	235
4. Branch Distributor (to terminate in less than 12 months)	50 4.25	109
5. Retail Dealers On-Premise	25	11,363
6. Retail Dealers Off Premise	10	4,218
7. Wine and Beer Retailer's Permit	30	9,107
8. Importer's	5	256
9. Importer's Carrier's	5 plus an Importer's License	43
10. Temporary	5	1,369

SOURCE: Rates, Tex. Pen. Code Ann. (Vernon, 1951) arts. 667-3 and 667-23 1/4 (f) and (g); number issued, "Sixteenth Annual Report, Texas Liquor Control Board, 1950," p. 15.

Warehouses used by distributors and manufacturers solely for storage of domestic beer need not be licensed, but importation of beer cannot be made directly or indirectly to them. Warehouses or railway cars in which sales orders for beer are taken or money is collected for beer are deemed separate places of business for which licenses are required.[129] The truck of a licensed manufacturer or distributor from which beer is delivered and sold to a licensed retail dealer is not considered a separate place.

Licensing Procedure

The statute requires that applications for licenses, as well as for Wine and Beer Retailer's Permits be made in duplicate.[130] Most of them, however, are made in triplicate, two filed with the county judge and one forwarded to the district office of the Liquor Control Board having jurisdiction. After public notice, a hearing is held by the county judge who may approve or disapprove the application. At the time of hearing, applicants must pay a $5 fee to be deposited by the county clerk in the county treasury.

If the application is approved, the applicant pays the necessary license fees to the county tax assessor-collector. A copy of the application and the tax receipt are forwarded to the Liquor Control Board, which may refuse to issue the license for grounds specified in the act.[131] Licenses are issued in five copies--original for licensee, one copy for tax collector, one for district office, one for board files in Austin, and one marked "expiration Notice," to be mailed by the board from Austin 33 days prior to expiration date. All except Branch Distributor and Temporary Licenses are issued for one-year periods from date of issue. Branch Distributor's Licenses expire on the same date as the primary license. A license must be obtained for each place of business where beer is manufactured, sold, or imported.

Temporary Licenses

Temporary Licenses authorizing the holder to sell beer at picnics and parties and effective for only four days are issued by the License and Permit Section of the board or District Supervisors to holders of Wine and Beer Retailer's Permits or Retail Dealers On-Premise Licenses. One copy is given to the licensee, one filed in the District office and one is forwarded along with the $5 fee to Liquor Control Board headquarters.[132]

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129 Tex. Pen. Code Ann. (Vernon, 1951), art. 667-3 (i).
130 Tex. Pen. Code (Vernon, 1948), art. 667-6.
131 Ibid., and Tex. Pen. Code Ann. (Vernon, 1951), art. 667-5E.
132 "Rule & Regulation No. 41," September 9, 1949, Texas Liquor Control Board.

Restrictions on Licenses

Besides the restrictions on licenses and permits[133] already discussed, certain limitations are placed solely on licenses. Licenses are non-transferable, but a licensee may change business locations after application to the county judge, subject to protest and hearing as for original licenses. Requests for change of location may be denied on the same grounds for which original licenses may be refused. Only persons or firms holding both Manufacturer's or Distributor's and Importer's Licenses may import beer.[134] Mutilated or destroyed licenses may be replaced by the Board

License Renewals

Licenses must be renewed annually, and applications for renewal must be made 30 to 5 days prior to expiration date.[135] Fees are paid to the county tax assessor-collector, who must report to the board as required for original applications. The board may issue the license for which renewal application is made or, within five days, refuse it and require that procedure required for new applicants be followed. Renewal applications must be accompanied by a $2 fee for county use.

Refunds

No refund is permitted for surrender or non-use of a license. Should, however, a licensee be prevented from using a license for the full period for which issued because of the results of a local option election, refund of the fee for the unexpired portion is authorized.[136] Refund is also authorized if the application for license is refused by the board or court action.

Gallonage Taxes on Beer

Besides the license taxes required for permission to manufacture, sell, distribute, or import beer into the state, a tax of $1.37 per barrel of 31 gallons is levied on beer, whether manufactured in Texas or imported.[137] A barrel contains approximately 340 twelve-ounce bottles of beer, the most common size in which it is dispensed; the tax per bottle is about .41 of one cent.

Though gallonage taxes on beer were initially paid in the same manner as taxes on liquor and wine, through the purchase of stamps and affixing them to the bottle or other container, the method of payment was changed October 1, 1949.[138] The tax is now paid upon the basis of the beer sold during the month, in the case of domestic beer, and upon the basis of the beer imported during

133 Tex. Pen. Code (Vernon, 1948), art. 667-7.
134 Tex. Pen. Code Ann. (Vernon, 1951), art. 667-23 1/4.
135 Tex. Pen. Code (Vernon, 1948), art. 667-7.
136 Ibid., art. 667-18.
137 Acts 52d Leg., R.S., 1951, ch. 402, sec. XX, p. 719.
138 Tex. Pen. Code Ann. (Vernon, 1951), art. 23 1/4.

month, in the case of beer manufactured outside the state. This means that the taxpayer pays the tax on Texas beer after he sells it and that he pays the tax on imported beer after he buys it whether he has sold it or not. Payment is made monthly on or before the fifteenth of each month for the preceding month, upon the basis of reports accompanying the tax payment. Responsibility for making reports and paying taxes is placed upon manufacturers and importers. It might appear that only two classes of licensees--manufacturers and importers--are involved in the payment of beer gallonage taxes; since distributors may also be importers, however, another class is included. In 1950, nine Manufacturer's and 255 General and 241 Local Distributors Licenses were issued, all of which were eligible for Importer's Licenses. Only 260 Importer's Licenses were granted and these, plus the nine manufacturers, are required to make gallonage tax payments.

Reports must include total Texas beer purchased and sold, quantity imported, and deductions for out-of-state sales, common carrier claims and breakage, and sales to military installations. Although the control act expresses the rate per barrel, the report forms provide a breakdown for the various case and bottle sizes.

This inventory or report method of collection is apparently satisfactory. Delinquent collections through audits were considerably higher percentagewise in 1950 than in 1949, and this increase has been attributed to the confusion attendant upon the change in collection method.[139]

Exemptions

Two exemptions from the payment of gallonage taxes on beer are contained in the statute.[140] Beer manufactured in Texas and exported is exempt as is beer shipped to any national military establishment for consumption by military personnel. A third exemption, perhaps more in the nature of a deduction, is permitted in the report form which provides for the exclusion of "carrier claims and breakage" from taxable beer. Provision for this deduction does not transcend the intent of the tax act since the excluded beer is neither sold nor consumed.

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139 "Sixteenth Annual Report, Texas Liquor Control Board, 1950," p. 17.
140 Tex. Pen. Code Ann. (Vernon, 1951), art. 667-23 1/4 (d).

"Personal User" Importation

Individuals may bring into the state "tax paid" beer in quantities not to exceed 24 twelve-ounce bottles, or its equivalent if in containers of a different size, in any one day.[141] A railroad company may import beer in quantities necessary to meet demands of its passengers, except that no beer may be sold or served in dry territory aboard its trains. Persons desiring to import the permitted quantity of beer for personal use must make written application to the board giving the name of the person or firm from whom the beer is to be imported, the quantity, and the number and denomination of stamps desired. The Treasurer is then authorized to sell the requested stamps to the applicant.

Refund of Beer Tax

Should any tax-paid beer be subsequently shipped out of the state or to any national military establishment for consumption by military personnel, a claim for refund may be made by paying a fee of $5 to the board.[142] Claim for refund must be made under oath and supported by carbon copies of invoices and a signed copy of the bill of lading if handled by common carrier. Such claims are collectible only if made within 90 days of shipment.

141 Tex. Pen. Code (Vernon, 1948), art. 667-36, and "Rule and Regulation No. 16 Q-1," September 8, 1939, Texas Liquor Control Board.

142 Tex. Pen. Code Ann. (Vernon, 1948), art. 667-23 1/4 (d), and "Rule and Regulation No. 21-A," September 8, 1939, Texas Liquor Control Board.

SECTION 4 - COLLECTION AND ENFORCEMENT

It has been previously mentioned that four separate and distinct tax impositions are established by the Liquor Control Act. Two -- permit fees and license fees -- are levied primarily for regulatory and control purposes and produce an annual revenue approximating the cost of state regulation and tax administration; and two -- distilled spirits and wine gallonage tax and beer gallonage tax -- are selective sales or excise taxes producing the bulk of the tax revenue from alcoholic beverage sales and consumption. Numerous state and local officials are involved in the administration of these taxes.

Collection

The major portion of the revenue from distilled spirits and wine gallonage taxes is collected by the Treasurer through the sale of tax stamps.[143] Payment of tax on the particular commodity is denoted by affixing the tax stamp to the bottle or other container. Beer gallonage taxes are collected monthly by the Liquor Control Board from manufacturers and importers.[144] The Board's agents collect a small portion of the revenue from both of these gallonage taxes at border points of entry.

Fees for liquor permits, except Wine and Beer Retailer's Permits, are collected by the Liquor Control Board, each applicant forwarding the required amount with his application for original or renewal permit.[145] Except for Temporary Licenses, license fees and Wine and Beer Retailer's Permit fees are collected by county tax assessor-collectors.[146] They make monthly remittances to the board. Temporary license fees are collected by district enforcement offices and the License and Permit Section of the board.

Thus four agencies or groups of officials are engaged in the collection of alcoholic beverage taxes. Within the board itself, three of the four divisions -- auditing, accounting, and enforcement -- collect some liquor taxes. It would appear that the multiplicity of collecting agencies would pose difficult problems of administrative control, but the procedures have been worked out over the years so that they result in fairly smooth operation.

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143 Tex. Pen. Code (Vernon, 1948), art. 666-45 (b).

144 Tex. Pen. Code (Vernon, 1951), art. 667-23 1/4, (b) and (c).

145 Tex. Pen. Code (Vernon, 1948), art. 666-15c (2).

146 Ibid., art. 667-6 (b), (c), and (f).

Reports

Verification of gallonage taxes due is based on co-ordinated audits of some 13 different reports required monthly of some 20 different classes of permittees and licensees. Several permittees must file as many as four reports each month. Statutory authority for requiring reports is contained in several provisions of the Liquor Control Act, but the specific content and form of reports are governed chiefly by board regulation.

The board is authorized to require such reports and other data as it deems necessary to accomplish the purposes of the act.[147] In addition, the act specifies that certain reports be made. For example, wholesale liquor dealers, upon receipt of a shipment for sale within the state, are required to submit such reports and information as may be requested by the board.[148] Texas manufacturers of beer, out-of-state manufacturers whose beer is imported into this state, importers, and distributors may be required to furnish such reports on purchases, sales, and shipments as will enable the board to collect the full amount of taxes due.[149] Sworn statements of beer taxes due, as required by the board, must be furnished on or before the 15th of each month.

The types of licensees and permittees required to report and the reports submitted are indicated in Table AB-4. These are designed primarily to permit accurate cross-checking of each alcoholic beverage shipment from its manufacture, bottling, blending, or importation until its delivery to retail outlets, of the sale and disposition of all tax stamps, of invoices and dates of all stamp sales, of invoices and bills of lading for shipments transported by common and private carrier within the state, and of alcoholic beverages in storage. The content of each type of report has been extensively spelled out by board regulation.[150] Altogether some 2,500 reports are submitted each month,[151] responsibility for auditing and cross-checking these reports rests with the Austin office of the Auditing Division, consisting of the chief auditor, a secretary, and two other employees. Assuming a 22-day work month, this means that each of the three non-secretarial employees averages about 40 audits daily, making no allowance for other duties.

Control of Interstate Shipments

When an out-of-state manufacturer or distiller ships alcoholic beverages into Texas, he reports both to the liquor control agency in his state and to the Texas Liquor Control Board. The Texas board secures compliance reports by virtue of the issuance of Agents' or Manufacturers' Agents' Permits, without

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147 Ibid., art. 666-6 (a).

148 Acts 52d Leg., R.S. 1951, ch. 402, sec. VIII, p. 705.

149 Tex. Pen. Code Ann. (Vernon, 1951), art. 667-23 1/4 (h) and (k).

150 "Rule & Regulation No. 13 D-2," January 19, 1951, Texas Liquor Control Board.

151 "Sixteenth Annual Report, Texas Liquor Control Board, 1950," p. 17.

TABLE AB-4

Alcoholic Beverage Reports

Licensee or Permittee	Type of License	Date Due
Brewer	Monthly Inventory	10th
	Stamp Receiving Record	10th
	Receiving Record of Wine & Malt Liquors	10th
Distiller	Monthly Inventory	10th
	Stamp Receiving Record	10th
Class A Winery	Monthly Inventory	10th
	Stamp Receiving Record	10th
	Receiving Record of Wine & Malt Liquors	10th
	Daily Bottling Report	10th
Class B Winery	Monthly Inventory	10th
	Stamp Receiving Record	10th
	Receiving Record of Wine & Malt Liquors	10th
	Daily Bottling Report	10th
Rectifiers	Monthly Inventory	10th
	Stamp Receiving Record	10th
	Daily Bottling Report	10th
Wholesalers	Monthly Inventory	10th
	Stamp Receiving Record	10th
	Receiving Record of Wine & Malt Liquors	10th
	Wholesalers Receiving Record, Liquor	10th
Class B Wholesalers	Monthly Inventory	10th
	Stamp Receiving Record	10th
	Receiving Record of Wine & Malt Liquors	10th
Wine Bottlers	Monthly Inventory	10th
	Stamp Receiving Record	10th
	Receiving Record of Wine & Malt Liquors	10th
	Daily Bottling Report	10th
Carriers	Carrier Report	15th
Industrial	Industrial Alcohol Report	10th
Bonded Warehouse	Warehouse Report	Within 24 hrs. of receipt or withdrawal of liquor.
Medicinal	Monthly Report of Medicinal Pharmacy	10th

Table AB-4 (Brought Forward)

Licensee or Permittee	Type of License	Date Due
Non-Resident Sellers	Non-Resident Sellers Report	10th
General Distributor	Distributor's Monthly Report	15th
Branch Distributor	" " "	15th
Local Distributor	" " "	15th
Manufacturers	Manufacturer's Report	15th
Manufacturers, Wholesalers, Distributors, & Brokers Outside Texas Selling Beer Destined for Texas	Monthly Report of Out-of-State Shippers	10th
Importers Carriers	Carrier Report	15th
Railway Buffet, Club, or Dining Cars	Monthly Inventory of Beer or Wine Sold	Within 20 Days

SOURCE: "Rule and Regulation No. 13 C-1" August 14, 1939, Texas Liquor Control Board

which an out-of-state manufacturer may not ship his product into Texas. Besides these, the Liquor Control Board has two other reports on imported beverages for audit purposes, one from the carrier transporting the shipment and one from the recipient. Thus any discrepancy between reported exports and receipts can be discovered. As a matter of reciprocity, the Texas Liquor Control Board notifies other state liquor agencies of shipments originating in Texas. This co-operative arrangement for aiding enforcement has been perfected through the Association of Alcoholic Beverage Control Administrators.

Participation of Local Officials

County tax collectors making collections of license and Wine and Beer Retailers' Permit fees are required by the Liquor Control Act to furnish statements to the Board of amounts collected "at the times and in the manner required" by the board or administrator.[152] In practice, the board furnishes each tax assessor and collector at the end of each month with a statement showing the total licenses and permits granted through the county, the total fees that should have been collected and the total taxes due the state. This practice is possible because, as explained earlier in this chapter, the board is kept informed on a day-to-day basis of the actions of county officials with regard to licenses and Wine and Beer Retailer's Permits. Within five days of receipt of this statement, the assessor-collector must forward payment to the Liquor Control Board.[153]

When collecting the state fees for these licenses and permits, the county also collects a $2 fee for each renewal application and a $5 fee for each original application; these fees are retained for county purposes. In addition, the county tax collectors are permitted to retain as fees of office 5 per cent of all state license and permit fees collected.[154]

Enforcement

The entire Liquor Control Act is characterized as "an exercise of the police power of the State for the protection of the welfare, health, peace, temperance, and safety of the people of the State" and is to be "liberally construed for the accomplishment of that purpose."[155] The administrative efforts to enforce the two aspects of the law -- regulation of the sale and consumption of alcoholic beverages and taxation of its sale -- complement one another. Regulatory efforts, especially, reinforce and substantially assist the collection of the taxes and fees imposed. In view of this, it is difficult to isolate the purely tax enforcement activity from the rest of the work of the board. An individual enforcement official may be concerned with both aspects

152 Tex. Pen. Code (Vernon, 1948) art. 667-11.

153 "Rule & Regulation No. 15-A," dated September 1, 1937, Texas Liquor Control Board.

154 This fee of office is not expressly provided for in the Liquor Control Act. Authority for it is apparently found in Tex. Stat. (Vernon, 1948) art. 3939, which grants a 5 per cent fee of office for the collector's services on all occupation and license taxes.

155 Tex. Pen. Code (Vernon, 1948), art. 666-2.

of the law; and a given act of enforcement may aid the accomplishment of both purposes of the law. For example, efforts to find persons who sell liquor not bearing tax stamps contribute to both control of liquor traffic and collection of liquor taxes.

For tax purposes, audits of reports and records are made by the board's Tax Auditing Division, which employs 24 persons. Four of these are in the Austin office, and the other twenty are stationed either in one of three district offices in Dallas, Houston, and San Antonio, or in the field. This force makes periodic audits of records of wholesalers, bonded warehouses, carriers, industrial users, physicians, non-resident sellers, out-of-state beer manufacturers, board offices at ports of entry, and miscellaneous reports submitted by liquor boards and commissions of other states. In the calendar year 1950, this division conducted 744 audits covering tax payments of $14,171,269 and their audits resulted in the collection of $8,034 in delinquent taxes.[156]

The Enforcement Division of the board is also concerned with tax enforcement, although its major attention is focused upon liquor control. Despite the fact that approximately half the state is dry, district enforcement personnel are not distributed according to wet or dry status but according to population density. The impact of their activity on state revenue is reflected chiefly in total sales of confiscated beverages.

Records

Permit holders are required to keep daily records of all production or receipt of alcoholic beverages, amounts of tax stamps purchased, and of all except retail sales, including names of purchasers. The board may require additional records, all of which must be kept for at least two years and be open to inspection by authorized representatives of the board.[157]

Package-stores are required to keep extensive records only on certain sales. Since a wholesale transaction is defined as the sale of more than three gallons of liquor, package stores selling more than this quantity to a single purchaser must prepare invoices "in duplicate originals" giving name, address, and permit number of package store; month and date of sale; name and address of purchaser; license number of vehicle into which liquor is loaded; time of day sale or delivery is made; quantity and price in cases or gallonage of each brand and type of liquor; and the signature of person making sale or delivery.[158]

Holders of Manufacturer's or Distributor's Licenses are required to keep records of each day's production or receipt of beer and of each sale, including purchasers names. Entries of all transactions must be made on the days they occur, and the board or administrator may require such other records as deemed

156 "Sixteenth Annual Report of the Texas Liquor Control Board, 1950," p. 18.
157 Tex. Pen. Code (Vernon, 1948), art. 666-21c.
158 "Rule & Regulation No. 11 A-2," November 19, 1942, Texas Liquor Control Board.

necessary. The board has somewhat elaborated on these statutory provisions.[159] In general, permittees and licensees, except for retailers, must maintain records of all alcoholic beverages manufactured, distilled, purchased, received, blended, or bottled, including invoices, bills of lading, waybills, freight bills, express receipts, all other shipping records furnished by the carrier and shipper, names and addresses of persons from whom purchased and received, and inventories on the last day of each month. Those authorized to purchase stamps must maintain complete information concerning the details of such purchases and a monthly inventory of stamps on hand.

Prescriptions

Duplicate copies of all liquor prescriptions must be kept by the physician for at least two years.[160]

Transportation of Liquor

Carriers are required to accompany each shipment with "a written statement furnished and signed by the shipper, showing the name and address of the consignor and consignee, the origin and destination of such shipment, and such other information as may be required by rule and regulation of the Board," and must have it available for exhibition and inspection.[161]

159 "Rule & Regulation No. 12 A-1," Sept. 1, 1939, "No. 12 C-1," August 14, 1942, and "No. 12D-1," August 14, 1942, Texas Liquor Control Board.

160 "Rule and Regulation No. 12B-4, "September 1, 1941, Texas Liquor Control Board.

161 Tex. Pen. Code(Vernon, 1948), art. 666-27, and "Rule and Regulation No. 12C-1," August 14, 1942, Texas Liquor Control Board.

Police Powers

Extensive police powers are granted those charged with enforcement of the Liquor Control Act; although utilized mainly to enforce regulation, some are specifically intended to assure tax collections. The board, administrator, or any inspector directed by the board is authorized to issue subpoenas to compel the attendance of witnesses, and the production of pertinent records and accounts, administer oaths, certify to official acts, and take depositions within or without the state.[162] Contempt proceedings may be instituted against persons who refuse to perform the requested acts. Non-resident sellers must allow "any State officer," upon written request, to examine all records pertaining to their business and take copies of any of them which tend to reveal violations of the act.[163] "State officer" is defined as any representative of the board, the Attorney General, and his assistants or representatives.

The acceptance of a permit or license by an applicant is declared "an express agreement and consent" that any inspector or representative of the board or any peace officer may enter upon the licensed premises to conduct an investigation or examination.[164] All licensed premises are inspected at least once monthly and some are visited daily if constant surveillance is deemed necessary. These inspections may serve regulation more than tax collection, but board personnel are alert for violations of both the tax and regulatory provisions. Tax evasion is more likely to occur on unlicensed rather than licensed premises. Inspection of unlicensed business places where violations are suspected can be conducted only with a search warrant which may be secured upon the affidavit of a credible person; affidavits of two credible persons are required to search residences.[165] It can be seen that once a license has been secured, the task of tax enforcement is considerably simplified.

Bond

The board may require that all permittees be bonded in amounts varying from $1,000 to $25,000.[166] The bonds established for them are given in Table AB-1 in Section 3. However, where beer taxes are involved, only holders of Manufacturer's and Importer's Licenses are required to make bond.[167] The amount for these bonds must be sufficient to cover the licensee's anticipated tax liability for any six-week period, "but a minimum bond of $500 has been prescribed by the board. It is logical that only these two classes of licensees be bonded since they are the only ones that incur tax liability.

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162 Tex. Pen. Code (Vernon, 1948), art. 666-7.

163 Ibid., art. 666-15 1/2 (7).

164 Tex. Pen. Code Ann. (Vernon, 1951), art. 666-13 (d).

165 Tex. Pen. Code (Vernon, 1948), art. 666-20.

166 Ibid., art. 666-16.

167 Tex. Pen. Code Ann. (Vernon, 1951), art. 666 23 1/4 (j).

Penalties

Violations of the Liquor Control Act carry varying penalties. Perhaps the most effective and most easily utilized are those of cancellation or suspension of the license or permit. More offenses are enumerated for which these two may be applied than for any other penalty.[168] Suspension may be made effective for any period up to 60 days. Should no penalty be provided for a specific violation, conviction is punishable by a fine of from $100 to $1,000 or confinement in the county jail for not more than one year or both.[169] Confusion resulting from multitudinous and conflicting penalties, highlighted in the 1938 case of Moran v. State,[170] has not been thoroughly eradicated. Several penalties are indicated in the enumeration of the following violations.

Delinquency

Failure "to remit reasonably" any taxes due the state subjects permittee's or licensee's bond to liability for the amount due plus a penalty of 15 per cent of the face value of the bond.[171] Suit is seldom filed on a taxpayer's bond for any delinquency because threatened cancellation or suspension of license or permit is speedier and of more consequence. Too, not all licensees and permittees are bonded.

Refusal to Report or Permit Audits

Should any manufacturer, importer, or distributor of beer fail or refuse to make reports required by the board or refuse to allow the board to investigate records, whether located in Texas or not, the board may seize and prohibit the sale of any beer belonging to the manufacturer, importer, or distributor.[172]

Falsified Application

Any person who makes a false statement to the board in a sworn report, application, or instrument filed with the board is declared guilty of perjury and subject to the penalty prescribed for that offense by statute.[173]

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168 Ibid., art. 666-12e.

169 Tex. Pen. Code (Vernon 1948), art. 666-41 e.

170 122 S.W. 2d 318 (Tex. Crim. App., 1938).

171 Tex. Pen. Code (Vernon, 1948), art. 666-19.

172 Tex. Pen. Code Ann. (Vernon, 1951), art. 667-23 1/4, (h).

173 Tex. Pen. Code (Vernon, 1948), art. 666-17a.

Forgery and Counterfeiting

Forgery or counterfeiting of stamps, licenses, permits, and tax instruments is declared a felony punishable by confinement in the state penitentiary for from 2 to 20 years.[174] To discourage counterfeiting and aid in its discovery, there have been numerous changes in denomination, design, and color of tax stamps, some necessary because of rate increases. Stamps are numbered serially, too, and records of recipients show serial numbers of stamps received. As a control measure, a permittee may not sell or loan stamps to another permittee without board approval, which is rarely granted. Counterfeiting is not presently a problem, the most recent case in the memory of the present administration having occurred seven or eight years ago.

Illicit Beverages -- Confiscation

Engaging in any phase of the alcoholic beverage business without having secured a license and paid the requisite tax is declared unlawful.[175] Alcoholic beverages possessed in violation of this provision are declared illicit, and they, as well as any vehicle used for their transportation are subject to seizure with or without warrant by any agent or employee of the board or any peace officer. The seizing officer or agent is required to make an inventory of items confiscated, and falsifying a report of confiscated liquor is punishable as false swearing. Any peace officer who fails to make the required report may be punished, upon conviction, by a fine of $50 to $100 or confinement in jail from 10 to 90 days, or by both fine and imprisonment.

If the owner of confiscated beverages so desires, he may relinquish title to them voluntarily, in which case he signs a form supplied by the board for that purpose. This procedure is not uncommon if the quantity involved is small. Otherwise, court action for forfeiture is necessary. Upon a judgment of forfeiture, the board may dispose of the property; or if any of it, except alcoholic beverages, can be used by the board in the judgment of the board or administrator, it may be retained by that agency.[176] Confiscated beverages are accumulated in district enforcement offices until approximately 100 cases are on hand. These stocks are inventoried monthly. Should considerable time elapse before 100 cases are available in any one district, interdistrict transfers are made. Bid forms are then mailed to prospective buyers with a closing date. Sales are made to authorized permittees and licensees who request that they be placed on the mailing list for bid forms. The board is instructed "to exercise diligent effort to obtain the best available price" and may reject all bids.

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174 Tex. Pen. Code (Vernon, 1948) art. 666-28.

175 Provisions governing the confiscation and sale of illicit beverages are contained in Tex. Pen. Code (Vernon, 1948). art. 666-4 and Tex. Pen. Code Ann. (Vernon, 1951), arts. 666-3a, 666-30, and 666-42.

176 Tex. Pen. Code Ann. (Vernon, 1951), art. 666 42(b).

Confiscation of vehicles presents something of a problem. Most vehicles confiscated for violations of the act have liens against them. If a lien holder is able to establish the validity of his lien against the seized vehicle and prove his ignorance as to its use in violation of the act, sale is made by the county sheriff as provided for other property under execution. Proceeds are allotted first to pay court costs and expenses of the sale, second to the payment of liens according to priorities, and third to the board. Thus proceeds are considerably reduced before any revenue accrues to the state.

Thirty-five per cent of the revenues derived from confiscation sales is allotted to the board for the purchase and accumulation of evidence and to defray the expenses of handling confiscated property. Unexpended balances in this Confiscated Liquor Fund remain there from year to year, subject to appropriation.

Administrative Expenses

Administrative expenses of the Liquor Control Board are appropriated by the Legislature and deducted from alcoholic beverage gallonage tax revenues prior to their allocation to funds.[177] In addition, thirty-five per cent of receipts derived from the sale of confiscated property and temporary license fees are also retained by the board.

Earmarking

Revenues from permit and license fees, except from Temporary Beer Licenses and amounts necessary for refunds, are deposited in the Omnibus Tax Clearance Fund.[178] Revenues from liquor, wine and beer gallonage taxes, minus amounts necessary for administrative expenses and refunds, are deposited three-fourths to the Omnibus Tax Clearance Fund and one-fourth to the Available School Fund.[179] Sixty-five per cent of receipts from sales of confiscated beverages and property is deposited in the General Revenue Fund.[180]

In addition to application fees and five per cent of license fees, counties also receive all fines assessed for criminal convictions of violators. In 1950, these fines amounted to $562,635.

Refunds

Amounts necessary for license and permit refunds are deducted from license and permit revenue prior to its deposit to funds.[181] In the case of licenses, total refunds are limited to two per cent of license revenue. Just how

177 Tex. Pen. Code (Vernon, 1948), art. 666-21d, sec. 3.

178 Ibid., arts. 666-46 and 667-4

179 Ibid., and art. 667-23 1/2.

180 Tex. Pen. Code Ann. (Vernon, 1951), art. 666-30 (b).

181 Tex. Pen. Code (Vernon, 1948), arts. 666-15b and 667-18.

this limitation would operate in practice is not known, for license refunds have never equalled this percentage. Refunds for stamps and gallonage taxes on liquor, wine, and beer are also permitted from revenues prior to allocation to funds.[182]

Summary

From the preceding discussion, it appears that the Liquor Control Board has sufficient powers to assure the collection and enforcement of alcoholic beverage taxes. Practically every conceivable violation is provided for. The content of the statute evidences that attention has been given to modern administrative law principles. The board has exercised its rule-making power to implement the statutory provisions.

[182] Ibid., art. 666-45 (d) and Tex. Pen. Code, (Vernon, 1948), art. 667-23 1/4 (d).

SECTION 5 - RESULTS OF OPERATION

Pattern of State Alcoholic Beverage Taxation and Regulation

The majority of states place the responsibility for tax collection and enforcement in the agency that is responsible for liquor control. However, 19 states delegate the tax collection function to an agency other than the control agency.[183]

The sale of intoxicating beverages (those having an alcoholic content in excess of 3.2 per cent) is permitted in all except two states -- Mississippi and Oklahoma. Of these 46 other states, 27 administer alcoholic beverage control through separate agencies especially set up for that purpose; 10 through departments of finance, treasury, revenue or taxation; one places responsibility upon the secretary of state; one depends on the state law enforcement agency; one gives this duty to the department of business regulation; and another has two special agencies, one for beer and one for distilled spirits.[184] Of the remaining five, three regulate liquor through a separate agency but regulate beer traffic through the state law enforcement agency; one makes the Attorney General responsible for liquor control and the tax department for beer control; and one has three agencies involved in alcoholic beverage control and taxation.

The general administrative pattern in the states, then, is that the regulation of sale and consumption of alcoholic beverages is done by a state agency established for this special purpose. The general pattern is that the agency that has the liquor control function also has the tax function.

Beyond these similarities in administrative responsibility, internal organization of the control agencies varies considerably except in states where independent control agencies are provided. Most such boards are appointed by governors and have similar terms and salaries.

Seventeen of the 46 states permitting sale and distribution of both liquor and beer achieve alcoholic beverage control through state monopoly systems; and so are characterized as "monopoly states." In these states, the state reserves to itself the privilege of selling alcoholic beverages; however, generally the state does not preempt marketing at all levels or of all these beverages. For example, most monopoly states permit private businesses to sell beer. They generally levy no gallonage or excise taxes on distilled spirits but derive their chief revenues from retail or wholesale price markups.

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183 State Tax Guide, All States, (Commerce Clearing House, 1951) pp. 3521 ff.

184 Alcoholic Beverage Control, Joint Committee of the States to Study Alcoholic Beverage Taxes, 1950, Table 2, pp. 72-78.

Three states -- Vermont, Ohio, and Wyoming -- are exceptions; they collect taxes of $3.60, $1, and 80 cents per gallon respectively on distilled spirits.[185] There is little difference in the regulation and taxation of beer in monopoly states and the others. They all collect gallonage or excise taxes on beer, and most of them collect license fees.

Twenty-nine states provide for sale and distribution of all alcoholic beverages under local option systems, and 10 have some local option. The other 9 states have no such provisions.

Regulation vs. Revenue

Alcoholic beverage control statutes have generally been classed as regulatory or penal acts designed to prevent "certain socially undesirable conditions."[186] In this light, revenue yield from this activity would be subordinate to the primary aim of regulation. It is sometimes argued that high tax rates on alcoholic beverages tend to defeat this objective by multiplying the financial gain that could be realized through illegal activities. Similarly, although increases in the sales volume of alcoholic beverages would almost certainly add to state revenues, the increase might not be consistent with the policies for which control was instituted.

In opposition to this viewpoint is the belief that high tax rates tend to discourage consumption by increasing its cost and thus contribute to the control objective. There is undoubtedly a point beyond which tax rates should not be increased if the best control is to be realized, but opinions as to this maximum rate vary considerably. It seems clear, however, that it is the policy of all state tax and regulatory statutes to discourage the consumption of alcoholic beverages.

Administrative Costs

A determination of the cost of collecting Texas alcoholic beverage taxes cannot be made with precision because not all Liquor Control Board expenditures can be attributed to tax collections, since the board is also charged with the enforcement of regulation. As previously indicated, all divisions of the board are active, to a greater or lesser extent, in tax collection and enforcement. Despite these limitations, some observations may be made on the basis of data contained in Table AB-5.

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185 Kansas Legislative Council, "Liquor Control," Publication No. 158 (January 14, 1949), p. 5.

186 Alcoholic Beverage Control, op. cit., p. 55.

TABLE AB-5

Collections and Expenditures of Texas Liquor Control Board, 1936 - 1950

Year	Total Net Alcoholic Beverage Revenue (1)	Total Alcoholic Beverage Revenue as Per Cent Total Tax, License & Permit Revenue (2)	Alcoholic Beverage License & Permit Revenue (3)	Total Liquor Control Board Expenditures	Expenditures as Per Cent of Alcoholic Beverage Revenue
1936	$ 6,126,715	6.7	$ 853,792	$610,066	9.95
1937	6,950,498	6.3	919,865	973,944	14.01
1938	6,478,233	5.6	807,688	964,172	14.88
1939	6,652,269	5.6	804,297	823,376	12.38
1940	7,142,565	5.7	798,372	757,359	10.60
1941	9,024,391	6.6	794,082	801,626	8.88
1942	10,496,047	6.8	723,675	910,423	8.67
1943	10,629,878	6.9	704,768	825,288	7.76
1944	12,653,109	7.9	840,397	750,150	5.93
1945	14,543,692	8.5	1,084,399	807,010	5.55
1946	17,332,003	8.3	1,376,199	862,749	4.98
1947	14,658,689	6.2	1,423,437	972,045	6.63
1948	14,546,561	4.8	1,417,805	1,001,218	6.88
1949	14,054,300	4.5	1,387,460	1,078,575	7.67
1950	17,572,368	5.0	1,364,563	1,163,548	6.62

(1) Revenue has been adjusted for refunds.

(2) Total tax, license and permit revenue is omitted from the table but is given in Annual Reports of the State Comptroller. Though total revenues are on a fiscal year basis and revenues from alcoholic beverage taxes on a calendar basis, the comparisons are valid for noting trends.

(3) Alcoholic beverage license and permit revenue is also included in "Total Net Alcoholic Beverage Revenue, and is indicated here for comparison with expenditures.

SOURCE: Annual reports of the Comptroller of Public Accounts and the Texas Liquor Control Board.

Expressed as a percentage of collections, total Liquor Board expenses have varied from 4.98 per cent in 1946 to 14.88 per cent in 1938. From 1938 to 1946, the percentage decreased, but from 1946 to 1950 it rose slightly, declining somewhat in 1950. If this figure were considered the cost of administering the taxes, it would be extremely high; but it must be remembered that tax collection is not the only function represented.

As might be expected, the board's expenditures in absolute terms have risen over the years. Its early high was in 1937 -- $974,000 -- then it generally declined to $750,000 in 1944; since then it has generally increased to its all time high of $1,164,000 in 1950. To the extent that the board's expenditures are accounted for by its payroll expenses, the number of employees of the board over the years may be of interest. The number has ranged from a high of 289 in 1937 to a low of 226 in 1943. The number generally declined from 1937 to 1943 and since 1943 has generally increased; 250 persons were employed by the board in 1950. The enforcement division has throughout accounted for the bulk of the board's employees. This division had 193 employees in 1937, its high, and 165 in 1943. Enforcement division personnel accounted for 189 of the board's 250 employees in 1950.[187] Of the four divisions of the board, the enforcement division is probably more concerned with carrying out the regulatory aspects of the law and less with its tax aspects than any of the other divisions. In view of the foregoing information, it would seem that a considerable portion of the expenditures of the board are allocable to carrying out control purposes of the law.

Since the enforcement division is the major division of the board, measured in terms of number of employees, it may be appropriate to examine some data relating to its activities.

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[187] The data concerning the number of employees of the board is drawn from the Annual Reports of the Liquor Control Board. The dollar expenditure figures are taken from Table AB-5, and have been rounded.

TABLE AB-6

Still Seizures and Confiscated Liquor Sales 1937-1950

YEAR	No. of Stills Seized	Total Annual Still Capacity in Gals.	Liquor Seized at Stills in Gals. *	Receipts from Sales of Confiscated Liq.**	Confiscated Sales - Vehicles	Fines in Criminal Cases
1937	732		5,143	$ 11,880	$	$ 232,285
1938	731		3,008	20,420		230,648
1939	521	29,622	1,602	16,687		246,909
1940	422	23,328	1,488	22,011		181,877
1941	378	19,173	1,140	18,596		280,627
1942	236	11,557	756	71,105		406,281
1943	102	4,360	215	180,303		456,140
1944	162	8,558	142	87,259		409,019
1945	96		221	109,914		539,314
1946	61	2,920	77	152,186	1,117	535,338
1947	55	2,935	278	163,067	1,130	597,468
1948	66	3,660	153	88,431	1,475	565,818
1949	84	4,998	281	149,434		558,507
1950	81	5,005	259	127,182	1,568	562,635

* Only liquor seized at stills is tabulated. Seizures of alcoholic beverages in dry territory and unstamped liquor are excluded.

** These figures include only receipts from salable confiscated beverages. Liquor seized at stills, because it does not meet state requirements for labeling and content, is usually destroyed.

SOURCE: Annual Reports of the Texas Liquor Control Board, 1937-1950.

Although there were in 1950 only four fewer employees in the division than in 1937, their distribution has been changed considerably to meet existing needs. Whereas there were 120 inspectors and 14 bridge inspectors in 1937, there were 107 inspectors and 34 bridge inspectors in 1950. Whereas 732 stills were seized and destroyed in 1937, only 81 with a combined capacity of 5,005 gallons annually were seized and destroyed in 1950. Receipts from sales of confiscated liquor, however, increased from $11,880 in 1937 to $127,182 in 1950. Fines in criminal cases almost doubled from $232,285 to $562,635 in that period. Thus it appears that enforcement activity, once concerned largely with prevention of illegal manufacturing is now able to concentrate on enforcement of restrictions upon licensees and permittees, inspections at points of entry, and the discovery of illicit liquor. It can also be seen that the division, though concerned importantly with control, was directly responsible for producing certain revenue.

Tax Stamps

Because gallonage taxes on distilled spirits, wine, and malt liquor are collected through the sale of stamps, some consideration should be given to the cost of stamps. Table AB-7 shows expenditures for stamps from 1937 to 1950 as a percentage of total expenditures. This cost item has generally represented two per cent of the board's total expenditures, with .9 per cent in 1943 the lowest figure and 3.4 per cent in 1947 the highest. Not all stamps purchased by the board in a given year, however, were necessarily sold that year to licensees and permittees. Thus the annual variations in total cost of stamps have no special significance. At the same time, the decline from 2.2 per cent in 1949 to 1.3 per cent in 1950 does reflect a saving. The use of stamps for the payment of beer gallonage taxes was discontinued October 1, 1949, and no beer tax stamps were purchased in calendar 1950. It appears that an annual saving of some $6,000 was realized the first year after this change in procedure. Whether or not the increasing cost of printing distilled spirits stamps will eventually absorb this saving remains to be seen.

TABLE AB-7

Cost of Tax Stamps, Calendar Years 1937-1950

YEAR	Total Liquor Board Expenditures	Expenditures for Tax Stamps	Per Cent Expenditure for Stamps
1937	$ 973,944	$ 23,132	2.3
1938	964,172	16,905	1.7
1939	823,376	14,601	1.7
1940	757,359	11,471	1.5
1941	801,626	22,684	2.8
1942	910,423	22,537	2.4
1943	825,288	7,925	0.9
1944	750,150	21,516	2.8
1945	807,010	21,697	2.6
1946	862,749	20,364	2.3
1947	972,045	33,060	3.4
1948	1,001,218	25,869	2.5
1949	1,078,575	24,380	2.2
1950	1,163,548	15,945**	1.3
TOTAL	$ 14,113,041*	$ 266,141*	(Av.) 1.9

* Total may not equal sum of components due to rounding.

** Distilled spirits stamps only.

SOURCE: Annual Reports of Texas Liquor Control Board, 1937-1950.

Comparison of Rates

A comparison of alcoholic beverages tax rates is difficult to present in brief and meaningful form. The classification of the various beverages for tax purposes varies greatly and the graduation of rates is based upon alcoholic content by weight in some states, and in its content by volume or proof in others. Also, some states levy additional or temporary taxes; several collect sales, use, or transaction taxes on alcoholic beverages sales in addition to the ordinary excise and license taxes. This variation of classification by type and alcoholic content and the imposition of different forms of taxation means that severe limits exist upon a practicable comparison of rates on a precise basis. The fact that some liquor-manufacturing states, like Kentucky, impose something resembling a production tax on liquor further complicates the complex rate picture.

However, some indication of the tax rates of the several states can be given. Table AB-8 sets out the state taxes on liquor; Table AB-9 presents the tax rates on beer. A brief textual comparison of the taxes on light still wines (those containing 14 per cent or less alcohol by volume) and heavy still wines (those containing 14 to 24 per cent alcohol by volume) is also presented. This sample of tax rates should present a general picture of the rates in the various states.

TABLE AB-8

Excise Taxes per Gallon of Distilled Spirits, 1950
(Generally as of December 31)

Less than $1.00	$1.00 - $1.50	$1.50 - $2.00	$2.00 or More
California* .80	Arizona * $1.20	Colorado $1.60	Arkansas* $2.50[1]
Missouri .80	Connecticut* 1.00	Louisiana 1.58	Florida 1.92 - 3.84
Nevada .80	Delaware .75 to 1.00	New Jersey 1.50	Indiana* 2.00
South Dakota* .75	Georgia 1.00	New Mexico* 1.20-2.00	Massachusetts 2.25
	Illinois * 1.00	New York 1.50	Minnesota 2.75
	Kansas 1.00		N. Dakota 1.90-3.45
	Kentucky 1.28[2]		S. Carolina 2.72
	Maryland * 1.25		Tennessee 2.00
	Nebraska 1.00		Wisconsin 2.00
	Rhode Island* 1.00		
	Texas 1.408		

NOTE: Rates shown are not strictly comparable because of temporary taxes, enforcement levies, and variations in definitions. Monopoly states and certain others are omitted because of non-comparability.

* Also levy sales taxes.

[1] Plus wholesalers' tax @ 25 cents per case

[2] Plus 5 cents per gallon for production and importation and 5 cents per case for wholesalers.

SOURCE: Commerce Clearing House, Tax Systems, Twelfth Edition, 1950, and "Supplement to Twelfth Edition of Tax Systems," January 1, 1951.

TABLE AB-9

State Excise Tax Rates on Beer, 1950
(Per 31 gal. Bbl., over 3.2% Alcohol)

	State	Rate		State	Rate
1.	South Carolina	$13.95	25.	Minnesota	$ 2.20
2.	Mississippi	13.23*	26.	Massachusetts	2.00
3.	Lousiana	10.00	27.	South Dakota	2.00*
4.	Georgia	9.00	28.	Kentucky	1.50
5.	North Carolina	7.50*	29.	New Mexico	1.50*
6.	Florida	7.44	30.	Texas	1.364
7.	Oklahoma (3.2%)	7.00	31.	Oregon	1.30
8.	Arkansas	5.00* (32 gal.)	32.	Michigan	1.25*
			33.	Illinois*	1.24
9.	Maine (Imported: domestic	4.96 1.65)	34.	Nebraska	1.24
			35.	New Jersey	1.03
			36.	New York	1.03
10.	Vermont	4.65	37.	Connecticut	1.00*
11.	Utah	4.00*	38.	Delaware	1.00
12.	Tennessee	3.40	39.	Montana	1.00
13.	Alabama	3.31	40.	Rhode Island	1.00*
14.	Idaho	3.10	41.	Washington	1.00*
15.	Kansas	3.10	42.	Wisconsin	1.00
16.	Virginia	3.10	43.	Colorado	.93
17.	New Hampshire	3.00	44.	Maryland	.93*
18.	West Virginia	2.75*	45.	Nevada	.93
19.	Ohio	2.50*	46.	California	.62*
20.	Indiana	2.48*	47.	Missouri	.62
21.	Iowa	2.48*	48.	Wyoming	.62
22.	North Dakota	2.48*			
23.	Pennsylvania	2.48			
24.	Arizona	2.32*			

* Also levy sales taxes.

SOURCE: Commerce Clearing House, Tax Systems, Twelfth Edition, 1950, and "Supplement to Twelfth Edition of Tax Systems," January 1, 1951.

Distilled Spirits

Table AB-8 indicates the range in taxes on distilled spirits. Of the 29 states shown, 14 levy lower and 14 levy rates higher than the Texas rate of $1.408. In four states -- Florida, Minnesota, North Dakota, and South Carolina -- the rates are almost twice those levied in Texas. South Dakota collects a tax slightly more than half that collected in Texas. Most rates range from $1.00 through $1.50. Thus the Texas rate on distilled spirits is about the median.

Light Still Wines

The Texas rate on light still wines, 11 cents per gallon, is generally lower than in the majority of states.[188] Of 29 states tabulated, 7 have lower rates, 1 has the same, and 20 have higher rates. Three states -- Florida, Georgia and South Carolina -- have rates almost nine times as high as Texas. Most of the states, 22, have rates below 30 cents per gallon. Seven states have rates of 10 cents or less, and 17 have rates of 20 cents or less. Thus the Texas rate on light still wines falls in the lower quarter of the 29 states included.

Heavy Still Wines

The Texas rate on heavy still wines is, when compared with those of 28 other states, generally higher than in 10 states and lower than in 18 states. Thus it falls in the lower one-third of the states included. Two states, Georgia and Indiana, have rates nine time the Texas rate. More than half the states, 17, have rates of 25 cents or less. Viewed in this perspective, the Texas rate of 22 cents per gallon is not unusually low.

Beer

State gallonage tax rates on beer are more accurately comparable than are rates on other alcoholic beverages. Too, all states levy taxes on beer, whereas sale of distilled spirits and wine is prohibited in two states and some monopoly states levy no gallonage taxes on distilled spirits and wine.

Table AB-9 shows state tax rates on beer. They vary from $13.95 per 31-gallon barrel in South Carolina to $0.62 in California, Missouri, and Wyoming. Twenty-nine states levy a rate higher than that collected in Texas, and 18 states' rates are lower. Six states collect less than $1 per barrel; 15 states collect from $1 through $1.50; nineteen states impose rates from $2 to $5; and 8 states levy $5 or more per barrel. The Texas rate, $1.37 per barrel, though more than double the lowest, is only one-tenth the highest. Thus Texas collects considerably less per barrel of beer than most states.

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188 The data upon which the discussion of tax rates on light still and heavy still wines is based are drawn from Commerce Clearing House, Tax Systems, Twelfth Edition, 1950, and "Supplement to Twelfth Edition of Tax Systems," January 1, 1951.

Federal Alcoholic Beverage Excise and License Tax Rates

Factors influencing total revenues from alcoholic beverage taxes include federal excise and license rates.[189] The federal tax rate of $10.50 per gallon on distilled spirits is some $6 more than the highest state rate (Florida and North Dakota) and $9 more than the Texas rate. The federal rate on light still wines is lower than those in 15 of the 29 states included in this discussion. It is higher than in 14 states. The federal tax rate on heavy still wines is exceeded by those of only 6 of the 29 states. It is three times the Texas rate.

The federal tax rate on beer, $9 per gallon, is lower than three state rates -- those of South Carolina, Mississippi, and Louisiana, and equal to that of Georgia. Thus it is higher than the rate in 44 states and is about seven times the Texas rate.

No accurate comparison can be made as to federal license tax rates. However, the federal government collects only about one-sixth as much revenue from license fees as do all 48 states.

State License Taxes

No attempt is made to present a comparison of state license tax rates because of wide variations in the number and types of licenses and permits used. In fact, the permit and license fee pattern of each state seems *sui generis*. Thus, it seems impracticable to make even general observations.

However, some observations may be made relative to Texas licenses and permits. The number of Retail Dealers' Off-premise Licenses has shown the most rapid increase, more than 400 per cent since 1946. Number of Retail Dealers' On-premise Licenses has also shown marked increase -- from 1,046 in 1946 to 4,324 in 1950, or a 250 per cent increase. Conversely, the number of package stores has decreased from 4,708 in 1946 to 3,656 in 1950; Wine and Beer Retailers' Permits have increased slightly. The total number of licenses and permits for 1950 is only 41 per cent greater than the number in effect in 1946, and total license and permit revenues were only two per cent higher in 1950. They were from 17 to 20 per cent lower than 1946 figures in 1947, 1948, and 1949.

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[189] Federal license and gallonage tax rates are given in Commerce Clearing House, *Federal Tax Guide, 1951*, p. 233 and "Revenue Act of 1951, 82d Congress, 1st Session," (St. Paul, Minn.: West Publishing Co., 1951), Part V, secs. 451, 452; and 453, pp. 2841-2845; Part VI, sec. 461, p. 2846.

Revenues

Revenue from alcoholic beverage taxes in Texas has never accounted for more than 8 1/2 per cent of total state tax, license, permit, and fee revenue. The percentage has varied from that high in 1945 to a low of 4.5 per cent in 1949; it increased steadily from 1936 until 1945, when it reached a peak, declined through 1949, and increased slightly in 1950. Beer excise and liquor stamp taxes have consistently accounted for the major portion of alcoholic beverage taxes. In 1950, only about 7 per cent of total liquor revenue was received from license and permit fees.

Per capita collections from these taxes in Texas were $2.16 in 1950, as indicated in Table AB-10. Only five other "wet" states and the two dry states had lower per-capita collections for that year. They were Missouri, Nebraska, New Mexico, North Carolina, and Rhode Island, and the two dry states of Mississippi and Oklahoma. These states being "dry," collect alcoholic beverage taxes only on 3.2 beer and non-intoxicating wines. Several factors help explain, to a certain extent, Texas' unusually low per-capita collections. Approximately half the geographic area of Texas is dry and some 60 per cent of the population lives in dry territory. States for which percentages of the population living in dry areas were available, are given in Table AB-10. Most states also levy production taxes on alcoholic beverages, and these produce unusually high revenues in states where the beverage industry is concentrated. Rates, too, of course, determine per-capita collections. California, for example, with low rates on all alcoholic beverages, had a per-capita collection of $2.27 in 1950. Florida and South Carolina, with high rates, had per-capita collections of $8.60 and $6.77 respectively. The consumption pattern, too, obviously affects tax revenues. Southern and Southwestern states, as a general rule, have lower per-capita collections than do Northern, Midwestern, and Northeastern states. Federal per capita collections were $16.24 in 1950. Federal alcoholic beverage taxes collected in Texas exceeded state collections by slightly more than one million dollars.

It must be remembered that local units of government also collect alcoholic beverage taxes in most states. Available statistics, however, are so incomplete or indefinite as to make any possible comparisons meaningless.

The decline in total alcoholic beverage revenues in Texas for 1947, 1948, and 1949 was not peculiar to Texas. Total national expenditures for alcoholic beverages, including public revenues, reached a peak of $9.6 billion in 1947, only $140 million more than in 1946, and declined in 1948 and 1949.[190] They rose slightly in 1950. The greatest decline in expenditures was for distilled spirits. Expenditures for beer reached a peak in 1948 and declined slightly the next two years.

190 U.S. Department of Commerce, Office of Business Economics, news release, OBE-502, Comm.--DC--11950, dated June 28, 1951.

TABLE AB-10

Federal and State Alcoholic Beverage Tax Revenue, Fiscal Year Ending 1950*

STATE	State Tax Collections	Population	% Dry[a]	Per Capita	Federal Tax Collections
Alabama	$ 12,636,389	3,061,743	58.7	$ 4.12	223,372
Arkansas	5,423,377	1,909,511	33.3	2.84	230,199
Arizona	2,080,340	749,587	0.0	2.77	1,383,760
California	24,063,756	10,586,223	0.0	2.27	154,903,412
Colorado	4,269,243	1,325,089	4.4	3.22	6,992,603
Connecticut	8,401,881	2,007,280	2.1	4.18	11,650,618
Delaware	1,050,429	318,085	-	3.30	689,317
Florida	23,838,160	2,771,305	18.1	8.60	5,152,882
Georgia	10,491,124	3,444,578	62.2	3.04	1,291,872
Illinois	24,309,962	8,712,176	13.3	2.79	272,155,457
Idaho	3,943,511	588,637	0.0	6.69	555,423
Indiana	17,054,864	3,934,224	0.0	4.33	332,210,434
Iowa	12,116,544	2,621,073	0.0	4.62	6,596,335
Kansas	5,554,618	1,905,299	-	2.91	2,212,501
Kentucky	10,875,600	2,944,806	56.2	3.69	411,936,971
Louisiana	16,938,027	2,683,516	19.6	6.31	25,950,433
Maine	6,566,444	913,774	30.2	7.18	293,849
Maryland	5,983,268	2,343,001	10.0	2.55	165,338,300[b]
Massachusetts	21,961,966	4,690,514	5.1	4.68	38,428,425
Michigan	37,892,283	6,371,766	-	5.94	62,102,269
Minnesota	13,577,801	2,982,483	18.2	4.55	22,998,857
Mississippi[c]	2,376,785	2,178,914	-	1.09	202,366
Missouri	7,084,543	3,954,653	-	1.79	66,704,847
Montana	4,884,763	591,024	-	8.26	1,561,674
Nebraska	2,770,995	1,325,510	0.2	2.09	7,693,810
Nevada	510,376	160,083	0.0	3.18	219,433
New Hampshire	4,359,147	533,242	12.5	8.17	78,662
New Jersey	15,255,575	4,835,329	2.5	3.15	75,133,135
New Mexico	1,383,919	681,187	6.2	2.03	56,399
New York	68,584,159	14,830,192	0.5	4.62	212,345,402
North Carolina	8,541,376	4,061,929	74.1	2.10	857,094
North Dakota	3,273,487	619,636	0.0	5.28	138,976
Ohio	49,033,565	7,946,627	8.4	6.17	107,067,117
Oklahoma[c]	4,797,900	2,233,351	-	2.14	552,651
Oregon	10,794,307	1,521,341	0.5	7.09	3,669,753

Table AB-10 (Cont'd)

STATE	State Tax Collections	Population	% Dry[a]	Per Capita	Federal Tax Collections
Pennsylvania	$ 89,902,363	10,498,012	-	8.56	268,573,008
Rhode Island	1,698,469	791,896	0.9	2.14	6,206,402
South Carolina	14,349,381	2,117,027	0.0	6.77	379,644
South Dakota	3,003,544	652,740	-	4.60	67,903
Tennessee	8,120,977	3,291,718	68.0	2.46	4,036,735
Texas	16,673,292	7,711,194	52.7	2.16	17,627,852
Utah	4,252,088	688,862	0.0	6.17	1,249,596
Vermont	2,747,513	377,747	35.7	7.27	175,807
Virginia	22,496,756	3,318,680	11.1	6.77	3,868,058
Washington	16,973,926	2,378,963	0.7	6.71	18,140,479\d
West Virginia	9,953,805	2,005,552	8.8	4.96	623,563
Wisconsin	15,116,073	3,434,575	5.8	4.40	96,834,034
Wyoming	1,138,480	290,529	0.0	3.91	520,033

* Exclusive of import duties

\a Percentage of population living in dry areas as of January 1, 1946.

\b Includes Washington, D. C.

\c Non-intoxicating beer and wines only

\d Includes Alaska

SOURCE: State revenue, "Supplement to Twelfth Edition of Tax Systems," January 1, 1951, Commerce Clearing House. Population and Federal Revenue, "Public Revenues from Alcoholic Beverages," Distilled Spirits Institute, Washington D. C., 1951. Figures for per cent dry from "Liquor Control," Kansas Legislative Council, Publication No. 158, January 14, 1949, Tables I and II, pp. 2-3.

Since the major portion of alcoholic beverage revenue comes from distilled spirits, the abrupt decline in expenditures for this commodity was reflected in tax collections.

Revenues in Monopoly States

It is interesting to note that of the 27 states with per-capita collections in excess of $3.90, 17 are monopoly states. These states are concentrated in the northern half of the United States, both east and west, with only Alabama in the southern part employing the state monopoly system. The sale and distribution of beer is generally excluded from such systems. When making comparisons on the basis of per-capita revenues between monopoly and non-monopoly states, the various factors which affect alcoholic beverage tax revenue must be considered.

Refunds and Discounts

Considering total gross revenue, alcoholic beverage tax refunds have been relatively low, never accounting for more than 1.63 per cent. (See Table AB-11). In 1942, they were only .08 per cent of total revenues. This fact is probably attributable to the strict provisions regarding refunds and the fact is imposed on a relatively non-perishable commodity.

Discounts of two per cent of the face value of individual liquor tax stamp purchases in excess of $500 have been permitted since 1941, and such discounts have almost equalled two per cent of total stamp sales each year. (Table AB-12). Apparently only .04 of one per cent of liquor tax stamp sales were in amounts less than $500 in 1942. The largest number of sales in quantities of less than that amount were made in 1944. This discount undoubtedly encourages purchases in sizable quantities and lessens bookkeeping expense. Since its inauguration, it has apparently served this purpose effectively. Another argument usually presented to justify stamp discounts is that they compensate the affected taxpayers for the cost of affixing stamps. This justification has been discussed extensively in connection with cigarette tax stamps.[191]

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[191] A Survey of Taxation in Texas: Part II - Analysis of Individual Taxes (Austin:Texas Legislative Council, Staff Research Report No. 51-8, 1951), pp. 15-16.

TABLE AB-11

Alcoholic Beverage Tax and License Refunds, Calendar years, 1940 - 1950

	Total Gross Revenue	Tax & License Refunds	Per Cent Refunded
1940	$ 7, 142, 581	$ 16	--
1941	9, 036, 200	11, 809	. 10
1942	10, 505, 258	9, 211	. 08
1943	10. 638, 060	8, 182	. 07
1944	12, 706, 296	53, 187	. 41
1945	14, 584, 823	41, 131	. 28
1946	17, 377, 265	45, 262	. 26
1947	14, 902, 392	243, 703	1. 63
1948	14, 651, 813	105, 252	. 71
1949	14, 246, 827	192, 527	1. 35
1950	17, 632, 448	60, 080	. 34
TOTAL	$143, 423, 963	$770, 360	Av. . 53

SOURCE: Annual Reports of the Texas Liquor Control Board, 1940-1950.

TABLE AB-12

Discounts on Liquor Stamp Sales, Calendar Years 1942 - 1950

Year	Value of Liquor Stamps Sold	Liquor Stamp Discounts	Discounts as a Per Cent of Total Value
1942	$ 6,309,358	$ 123,735	1.96
1943	6,359,959	121,820	1.91
1944	8,322,931	158,059	1.89
1945	9,753,447	187,409	1.92
1946	12,055,649	233,345	1.93
1947	8,883,496	171,639	1.92
1948	8,434,487	163,913	1.94
1949	8,427,316	160,589	1.90
1950	10,209,245	194,489	1.90

SOURCE: Annual Reports of the Texas Liquor Control Board, 1942 - 1950.

SECTION 6 -- SUMMARY AND PROBLEM AREAS

The preceding discussion of alcoholic beverage taxes indicates that they have had a very long historical development in Texas, beginning in the days of the Republic. Although they were levied chiefly in the form of license fees until the adoption of state prohibition, both gallonage and license taxes have been used since 1935. During the last fifteen years, procedures have undergone almost constant revision to meet the demands of taxation and regulation, which was largely in the hands of local officials prior to the creation of the Texas Liquor Control Board. It is probable that neither tax nor regulatory procedures have reached their ultimate development. The operation of the Liquor Control Act and its enforcement have, nevertheless, reached a high degree of effectiveness. Because this discussion has been concerned chiefly with taxation, an attempt has been made to deal with regulatory aspects of the control act only as they affect taxes and revenues.

This section is intended to highlight some of the more important and apparent problems which have been disclosed in the preceding discussion and to set out some readily apparent approaches toward their solution. As mentioned in the Introduction to this volume, in delineating the problem areas it is not intended to indicate that a change is either desirable or undesirable, and in reporting alternate approaches, no effort has been made to evaluate their desirability or practicability. The function of this section is to assist any legislative consideration of this tax.

The apparent problem areas are:

(1) Lack of clear statutory organization and inconsistencies among provisions of the control act.

(2) The difference between state and federal import allowances.

(3) The use of stamps in the collection of distilled spirits, wine, and malt liquor gallonage taxes.

The Liquor Control Act

Since its enactment in 1935, the Liquor Control Act has been amended considerably. Most amendments have been added to meet immediate needs for changes in enforcement, omissions in prior acts, or increases in tax rates. Apparently because it is easier to secure passage of a single amendatory act containing all proposed changes in a new section, unrelated matters have often been grouped together. The result is a disorganized statute which must be intensively studied to locate all provisions governing a specific subject. The

The sections dealing with the printing and distribution of liquor and prescription tax stamps are one example of this disorganization. The ambiguities in penalty provisions have also been discussed; it is probable that other conflicts have not been reconciled simply because they have gone unchallenged.

Although it appears certain that tax administration and alcoholic beverage control are not lacking in effectiveness because of this difficulty, the work of the Liquor Control Board personnel and the orientation of licensees and permittees could be appreciably simplified. In a reorganization of the act, the present structural division between permit and license procedures for distilled spirits and beer might be retained, but definitions, enforcement powers, penalties, local option election procedures, tax rates and marketing practices might be treated independently of permits and licenses. A logical arrangement of the various provisions would also be desirable.

"Personal User" Importations

While the difference between the import allowance of the federal and state law probably does not pose a major tax and enforcement problem, it may deserve attention. As explained earlier in section 3, Texas permits the importation of no more than one quart of distilled spirits and wine and of no more than 24 12-ounce bottles of beer and requires that the tax be paid. The federal government, on the other hand, allows the importation, tax free, of one gallon of any combination of alcoholic beverages. No pervading evils are produced by this difference, but the ill will of residents of other states who, aware only of the federal law, have three of their four quarts of imported liquor confiscated by board inspectors is not the only result. Besides the time bridge inspectors spend in explaining the Texas law, time is spent in replying to letter complaints received at board headquarters. Paralleling state and federal import allowances would permit the diversion of these efforts to other liquor tax and enforcement purposes. The ill will engendered among purchasers from other states and sellers in Mexico is difficult to measure and is hard to assign proper importance.

Increasing the Texas "personal user" import allowance from one quart of distilled spirits and wine to that permitted under federal law would also affect revenues. If this change were made, it is probable that some non-residents would bring across the international border four quarts instead of one quart of liquor. This would mean that in some cases, at least, Texas would collect a tax on three additional bottles of liquor which would not otherwise be purchased so as to be taxed by Texas. Texas presently derives some income from the sales of liquors confiscated because of its present import allowances. Whether any additional gallonage tax revenues resulting from a change in import allowances would significantly exceed that now obtained from the sales of liquor confiscated under these circumstances cannot be estimated upon available data.

If consideration is given to increasing the import allowance to agree with the federal, attention should be given the impact such a change would have upon liquor regulation. It should be remembered that a large part of the state is dry and the possession of more than one quart of alcoholic beverages in dry territory constitutes prima facie evidence that it is possessed for resale. How could an import allowance of one gallon of liquor be fitted with this presumption? Would not the expressed will of the dry counties on the borders of the state be partially negated by permitting import of a gallon instead of a quart from adjacent states and Mexico? A possibility would be to increase the import allowance only for those beverages crossing the international border and retain the present allowance for liquor brought in from adjacent states; but whether this distinction would be proper is not certain. Another solution might be the use of a different color stamp to indicate tax payment on liquor, brought across the Mexican border; this would permit continued application of the one quart presumption and aid liquor control. However, the increased cost of stamps, though not a large item, might consume a sizable portion of any increased tax revenues resulting from the change.

The change in the import allowance would probably not result in any serious diversion of consumer purchasers into adjacent states. All these states have "fair trade" laws permitting resale price maintenance. Tax rate differentials, also, would seem to discourage out-of-state purchases; Oklahoma is dry; Louisiana and New Mexico rates are higher than Texas rates; and Arkansas rates are approximately the same as those in Texas. With regard to the Mexican border, this situation may be different. Because there would be no federal excise tax or for other economies, persons along the Texas-Mexico border might buy a significant quantity of their alcoholic beverages in Mexico, to the detriment of the Texas alcoholic beverages concerns in that area. Though not of state-wide impact, this aspect of the problem also deserves consideration.

Collection Methods

It is perhaps too early to evaluate fully the results of the change from beer tax stamps to the present report or inventory method for collecting beer taxes. Some saving has already been realized, however, and evidently neither revenues nor regulation have been adversely affected.

In view of the apparent success of this collection method for beer, some consideration of the present stamp method for collection of distilled spirits, wine, and malt liquor taxes is perhaps warranted. A change to the use of reports, with monthly payments, would have two immediate results insofar as revenues are concerned. First, the cost of printing stamps would be eliminated. This item amounted to only $15,945 in 1950 and is relatively insignificant. Second, there would be no further need for discounts to stamp purchasers. Unlike printing costs, considerable revenue -- $194,489 in 1950 -- is involved in discounts. Detailed reports and records which could possibly be utilized for tax audit purposes with little change are not required from those responsible for payment of these taxes.

As to interstate shipments arriving in Texas, the exchange of reports now practiced by the various state liquor control agencies would continue to contribute to effective tax enforcement and would assure coverage of liquor manufactured in other states. A third cost which might be reduced is that now represented by administrative personnel supervising stamp sales. However, no real gain might be realized in this area because increased audit requirements might absorb any saving. Several states, notably New York and California, have employed a reporting system for the payment of distilled spirits and wine gallonage taxes for a number of years, without apparent loss of revenue. A study of their collection methods might reveal procedures which could be advantageously utilized in Texas.

This discussion of the revenue increases to be realized through a change in the collection method ignores the control aspects of alcoholic beverage stamps. It may be that the use of stamps is primarily justified by their contribution to effective regulation. Undoubtedly, stamps do simplify the task of enforcement personnel in discovering beverages on which taxes have not been paid. Adequate report and audit procedures might minimize this difficulty.

The federal government too, makes available to the Liquor Control Board the names of purchasers of federal strip stamps and thus contributes to the discovery of stills illegal under the Texas statute, which sometimes are licensed by their owners under federal law to avoid being charged with federal offenses. Though this arrangement does not assure discovery of operations that are illicit under both federal and state law, it could continue to be utilized in the absence of tax stamps. At any rate, stamps would probably still have to be employed at ports of entry for imported beverages, but discounts do not enter into these collections.

Although not directly related to taxation of alcoholic beverages, one other matter should perhaps be noted. Recently there has been an increase in "private clubs." These clubs provide their members with "set-ups" and cocktail mix to which is added liquor from the member's supply, either stored in a rented locker situated on the premises or brought with him to the club. If the carefully formulated arrangements are carried out, these clubs do not transgress the law. However, the spread of this arrangement for the consumption of liquor may mean that the Legislature will be asked to examine whether the spirit of liquor control is being complied with in this situation. In any legislative deliberation, attention should probably also be given to the tax aspects of this situation.

In Conclusion

The pattern of alcoholic beverage taxation in Texas has been influenced by the nature of the business and the social environment in which it operates. Considerable effort has been expended on regulation of alcoholic beverages by both government and society. Taxation on the basis of quantity sold is a relatively

recent development, but has proved a productive source of revenue. Precluding rate changes, revenue from this source depends chiefly on consumption patterns which are determined by various factors. Perhaps the two principal factors affecting consumption are the status of local option prohibition throughout the state and the level of prosperity.