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TAXPAYER'S PARADISE IN THE CARIBBEAN

ROBERT M. BAKER* and JAMES E. CURRY**

A new industrial tax exemption statute became law in Puerto Rico on May 12, 1947.¹ This island possession of the United States, located eight hours away from New York's LaGuardia field is already free of all federal income taxation. In the past, this favorable factor in its competition with mainland communities has been offset to a large extent by a very heavy local income tax. But industrialists who operate under the new exemption will be free of both federal and insular income taxes, as well as property and other local taxes.

Puerto Rico is closer, in terms of transportation costs, to the seaboard cities of the United States, with more than half of the nation's buying power, than is Pittsburgh or St. Louis.^{1a} The temperature in Puerto Rico on the coast varies between a mean winter temperature of 73.4° Fahrenheit and a mean summer temperature of 78.9°, with temperatures from 5 to 10 degrees lower in the mountains. Heating of homes is unknown and construction and clothing costs relatively low. These savings naturally reduce labor costs.^{1b} The new generation of grammar school graduates speak and understand English. Yet, with all these advantages, few industrial or commercial enterprises have been launched in Puerto Rico. The tradition of an agricultural colonial economy and the lack of mechanical training among the people of the island are largely responsible for this reluctance of investors. A growing awareness that the island must industrialize or starve^{1c} has led the Insular Government to make strenuous efforts to encourage investors. An intensive vocational training program and the promise of tax exemption are the two main features of this appeal to industry.

A substantial development of industry may well be anticipated in response to this appeal. To date, 49 applications have been received from manufacturers of buttons, canned goods, rainwear, eyedroppers, coconut concentrates, pastry fillers, multigraphing, embroidered blouses, milk bottle caps,

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1. Laws of Puerto Rico (1947), Act. No. 346, approved May 12, 1947, as amended by Act No. 22 of December 5, 1947. The amendment increased the basic period of exemption from ten to fifteen years and also exempted from taxation the transfer of the assets of an exempt subsidiary of its parent corporation.

1a. F. S. Cohen, *Science and Politics in Plans for Puerto Rico*, 3 Journal of Social Issues 6, 13 (1947).

1b. The Puerto Rico Handbook reviews (at p. 32) minimum wage rates established in Puerto Rico under a special exemption contained in the Federal Wage and Hour Law. They run as low as fifteen cents an hour as compared to the universal minimum of 40 cents per hour in the States.

1c. Puerto Rico Handbook (Office of Information for Puerto Rico) p. 6.

ice cream cones and soda straws, gloves and polished diamonds. None have been rejected. Applications have been granted for manufacturers of candy, furniture, chinaware and brassieres.

Previous tax exemption laws in the United States have not been so successful in attracting new industry as fully to justify the hopes of their sponsors. But tax exemption as used in the economic warfare between communities in the past, may be compared to the new Puerto Rican law only as older weapons of international warfare may be compared to the atomic bomb.

SCOPE OF THE EXEMPTION

The purpose of this Act (No. 346), as stated in its preamble, is "to define new industries in Puerto Rico; to protect same by temporary tax exemption." Legislation with a similar purpose had previously been enacted in Puerto Rico,² but the scope of the present statute is much wider than that of its predecessors.

The new law provides that the Executive Council of Puerto Rico, with the Governor's approval, shall grant "temporary exemption from property and income taxes, and from excise, license, or other municipal taxes" to applicants who prove "to the satisfaction of the Executive Council that the applicant has established or will establish a new industry in Puerto Rico." The exemption extends to all property, income, and activities connected with the exploitation of the new industry. It is a total exemption until June 30, 1959, after which date, three years of partial exemption (75%, 50%, and 25%) are provided. All exemption expires after June 30, 1962 unless further extended by the Legislature.

The full impact of the Act is found in the definition of "new industry." The predecessor statute of 1936³ had defined the term as follows:

"For the purposes of this Act, *new industry* shall be understood to be all such methods of processing and manufacture, either by hand or by machinery, as by transforming raw material, shall have as their object the production of articles of commerce never before produced in Puerto Rico; *Provided*, That such processed or manufactured products, properly finished, as may be utilized in connection with such industries, shall not be considered as raw material."

Act No. 346 follows this definition in part, but expands it and makes its coverage more specific. "New industry" is to be understood "to be all such methods of processing and manufacture, either by hand or by machinery, as shall, by transforming raw material, have as their object the production, in

2. Act No. 92, promulgated March 13, 1919, as amended by Act No. 16, approved May 20, 1925; Act No. 40, approved April 25, 1930; Act No. 94, approved May 14, 1936.

3. Act No. 94, approved May 14, 1936, § 2. This definition is substantially the same as that found in Act No. 40, approved April 25, 1930, § 1, with the addition of the limiting proviso.

Puerto Rico," of articles of commerce within any of three named categories:

First: Such articles as have been produced in Puerto Rico since January 2, 1945 by industries qualified for exemption under the exemption law of 1936,⁴ but which had not applied therefor nor had an application pending on March 29, 1947. This category is presumably a fairly limited one.

Second: "Articles of commerce which were not in production in Puerto Rico in commercial scale on January 2, 1947, and for the production of which there was not, on that date, any factory establishment, or any other organization."

Third: Any of a long list of enumerated articles.⁵

The inclusion of many of these items in the definition of "new industry" involves an unprecedented expansion of the scope of the term, for a number of them have been in commercial production in the island for some time. Under specified conditions these old industries will likewise be entitled to the "new industry" exemption. Regarding previously established plants the Legislature further provided that no plant which produced, or could have produced, any of the enumerated articles in the two months preceding January 2, 1947, would, solely on that account, be entitled to an exemption, until such an exemption is granted to some person who "establishes in Puerto Rico in good faith, in the judgment of the Executive Council, after the date of the approval of this Act, industrial facilities for the production of such articles in commercial scale." When newly created establishments qualify for tax exemption older firms in the same line of business will immediately be qualified for an equivalent exemption.⁶ This result is indicated also by the express

4. See note 3 *supra*.

5. The articles enumerated are: (1) fishing tackle, including nets and rods; (2) pottery; (3) articles of straw, reed, and other fibers; (4) rugs; (5) bonbons; (6) shoes; (7) caramels; (8) ceramics, including bricks, tiles, sanitary supplies, and other clay products; (9) preserved citron; (10) cigarettes; (11) cigars; (12) bed springs; (13) slippers; (14) toys; (15) cosmetics; (16) glassware; (17) cotton, silk, or rayon hosiery; (18) fine cardboard and paper pulp; (19) soaps; (20) tin containers; (21) water and oil paints; (22) tannery products; (23) polishing of diamonds and of other precious and semi-precious stones; (24) crackers; (25) canned products; (26) gloves and billfolds; (27) construction of coach or bodies of motor vehicles; (28) furniture manufacture; (29) food pastes; (30) vegetable oils; (31) balls for baseball and other sports; (32) embroidery; (33) matches; (34) mattresses; (35) preserved fruits; (36) articles produced by assembly plants. By assembly plants shall be understood those factories engaged in the production of articles of commerce, excluding furniture, by putting together the parts, provided the cost of the work of assembling the article represents such a substantial part of the total cost of the article that in the opinion of the Executive Council the industry deserves the exemption herein provided; (37) cheese; (38) artificial flowers; (39) production of cinematographic jobs in motion pictures exhibited for commercial purposes; (40) production of fiber from coconut and other fibrous plants, and the products derived therefrom; (41) candles.

6. In this respect the Puerto Rican statute is somewhat unique. Most "new industry" tax exemptions apply only to enterprises to be established subsequently to the effective date of the enacting statute. See *Baugh, Kennedy & Co. v. Ryan*, 51 Ala. 212 (1874); *Yocona Cotton Mills v. Duke*, 71 Miss. 790, 15 So. 929 (1894); *Victor Cotton Oil Co. v.*

provision that enjoyment of tax exemption under Act No. 94, approved May 14, 1936, "shall not prevent the application for, and obtention of, tax exemptions in accordance with the provisions hereof."⁷ Very properly there will be no grant of a competitive advantage to a new firm as against an older one in the same line of business. However, it is not the problem of competition with insular plants that is of importance from the viewpoint of manufacturers now operating in the continent. Rather, it is the tremendous competitive advantage that the migrant industrialist, in common with those already established in Puerto Rico, will have over stay-at-home competitors on the continent.

ADMINISTRATIVE PROVISIONS

In anticipation of the administrative and legal problem whether an applicant is within the definition of "new industry," the statute provides that the Executive Council (the Governor's cabinet) "shall hold such public hearings as it may deem pertinent."⁸ Such hearings before the Special Secretary for Tax Exemption (or a special master) are to be held where "warranted on the basis of the information presented by the petitioner," after notice to all parties and by general publication.⁹ In the determination of each petition, the Executive Council is required to consider reports made thereon by the Industrial Development Company of Puerto Rico and the Development Bank of Puerto Rico (both governmental corporations) and the Puerto Rico Planning, Urbanizing, and Zoning Board.¹⁰

Where a hearing is held, the Council also is to consider "the evidence adduced at the hearing . . . and the report and recommendation of the Special Secretary or the special master."¹¹ The law provides that "in cases in which it appears from the information presented by the petitioner in the petition and accompanying documents that the industry for which he is seeking tax exemption does not qualify under the terms of Act No. 346, the Executive Council and the Governor may disapprove the petition without the holding of a public hearing," but only after considering the reports of the three specified

Louisville, 149 Ky. 149, 148 S. W. 10 (1912); expressly overruling *Mengel Box Co. v. Louisville*, 117 Ky. 735, 79 S.W. 255 (1904). Under this rule, it has been held that a new manufacturing plant built after a previously existing one had been totally destroyed by fire, was not within a "new industry" tax exemption: *Morris v. Riley*, 135 Miss. 1, 99 So. 466 (1924). *Contra*: *Rixford Mfg. Co. v. Highgate*, 102 Vt. 1, 144 Atl. 680 (1929) where the former plant was destroyed by flood.

7. § 7.

8. § 5 (2).

9. *Regulations for Tax Exemption for New Industries*, promulgated by the Executive Council of Puerto Rico on July 30, 1947 (hereinafter cited as *Regulations*) § 7.

10. § 4 (5) proviso; *Regulations*, § 8. These reports are to be rendered by the agencies named within 15 days after receipt of a copy of the petition from the Special Secretary: *Regulations*, § 6.

11. *Regulations*, § 8.

agencies.¹² Thus, the technical expertise of the existing interested administrative bodies will be available to the Council in reaching individual decisions.

The present act is far more sweeping than its predecessors in aspects other than the definition of "new industry." The 1936 statute, for example, excluded assembly plants from its operation by a limiting proviso in its definition of "new industry," while the present act specifically includes such enterprises. That act, furthermore, authorized the Public Service Commission to prescribe the period of exemption, not to exceed ten years, whereas the present act specifies a temporal duration applicable to all beneficiaries. Thirdly, the 1936 statute expressly excluded income taxes from the exemption, while the present act expressly includes them. And, lastly, Section 5 of the former law worked a severe limitation completely antithetical to the provisions of the present one:

"When an industry has been acknowledged as new in Puerto Rico and the exemption provided by this Act has been granted to it, tax exemption shall not be granted to any other similar industry established thereafter."

The 1919, 1925 and 1930 laws were of substantially the same limited application as compared to the present enactment.

PURPOSES OF THE ACT

The purpose of this legislation is fairly obvious. The temporary industrial conditions of wartime under which Puerto Ricans were comparatively well occupied and comparatively well paid are largely dissolving into the more permanent features of the Puerto Rican economy.¹³ The most striking characteristics of that economy have long been the dominance of sugar production,¹⁴ and the prevalence of widespread unemployment.¹⁵ Puerto Rico has been called a financial liability to the United States, for she is not required to contribute directly by way of federal taxes to the support of the Federal Government, yet does receive considerable federal financial assistance of

12. *Regulations*, § 8.

13. The Puerto Rican economy has been termed "an economy of colonial exploitation," by Senator Vicente Geigel Polanco, floor leader of the Popular Democratic Party of the Puerto Rican Senate, 79th Cong., 1st Session, Senate Committee on Territorial and Insular Affairs, Hearings on S. 227, *Independence for Puerto Rico*, 46 (1945). See in accord, DIFFIE, *PORTO RICO: A BROKEN PLEDGE* (1931).

Descriptive surveys of this economy may be found in the Office of Information for Puerto Rico, *PUERTO RICO HANDBOOK* (1947); U. S. Tariff Commission, *The Economy of Puerto Rico* (1946); and Puerto Rico Department of Agriculture and Commerce, *Puerto Rico, Industrial and Commercial* (1941).

14. Puerto Rico Department of Agriculture and Commerce, *What Sugar Means to Puerto Rico* (1940); GAYER, *THE SUGAR ECONOMY OF PUERTO RICO* (1938). See also DIFFIE, *op. cit. supra* n. 13, ch. IV, concluding that, as of 1931, "Sugar Economy" has proved to be 'bad economy' for Porto Rico." (p. 88).

15. De Golia, *Puerto Rico: What It Produces and What It Buys*, U. S. Dept. of Commerce, *TRADE INFO. BULL.* No. 785, 11 (1932), reports that there is an "average unemployment of about 40 per cent of the working population of the island." The situation

various types just as do the states.¹⁶ Her citizens are exempt from the federal income tax and customs duties are collected but turned over to the local government for internal use.¹⁷

The encouragement of industry by means of the new tax exemption law is thus directed primarily toward solution of the unemployment problem,¹⁸ and indirectly at diversification of the Puerto Rican economy, lessening financial dependence upon the United States, and decreasing the magnitude of imports from the United States, most necessities of life being purchased at tariff-protected American prices.¹⁹

CONSTITUTIONAL VALIDITY

Industrial tax exemption laws occupy a rather anomalous position in the framework of constitutional law.²⁰ Direct subsidization of private in-

is referred to in terms of Puerto Rico's "chronic unemployed army" by the insular Commissioner of Labor: Puerto Rico Dept. of Labor, *Annual Report for 1941-42*, 10. See *infra* n. 152.

An obvious clue to the motive behind Act No. 346 is found in the statement of this same official in *ibid.*, 1939-40, p. 52: "The huge availability of low-cost labor in Puerto Rico would seem a most important factor for the expansion of the industries already existing in our country or introduction of new ones. In fact, however, our industrial activities along new lines of enterprise have had a tardy increment in recent years, despite strenuous efforts on the part of our insular authorities to attract more capital investments towards industrializing our Island."

16. U. S. Tariff Commission, *op. cit.*, *supra* n. 13, p. 11 *et seq.*; ROOSEVELT, COLONIAL POLICIES OF THE UNITED STATES, 107 (1937). Senator Ellender of Louisiana, addressing a Puerto Rican witness, 78th Cong., 1st Session, Senate Committee on Territorial and Insular Affairs, Hearings on S. 952, *Puerto Rico*, 196 (1943), stated, "In the period 1933 to 1941 the Federal Government spent for relief and for grants to Puerto Rico over \$300,000,000, or a total of \$37,500,000 per year. Now, you have obtained that sum out of the Federal Treasury without having put up one red cent in return." This, of course, does not take account of indirect contributions of Puerto Rico to the Federal Treasury, as for example, in the income or profit taxes of continental residents investing in insular industries.

17. ORGANIC ACT, 39 STAT. 954 (1917), 48 U. S. C. § 734; 31 STAT. 78 (1900), 48 U. S. C. § 740; INT. REV. CODE, § 3360 (c).

18. See statements of Dr. Blas Herrero, member of the Puerto Rican Senate, Hearings on S. 952, cited *supra* n. 16, p. 152 *et seq.*, and testimony of Hon. Bolivar Pagán, Resident Commissioner of Puerto Rico to the United States, *ibid.*, p. 239 *et seq.* The Department of Labor of Puerto Rico has attempted to assist in industrial expansion and location by means of vocational training programs to supply skilled workers: Puerto Rico Dept. of Labor, *Annual Report, 1936-37*, 10-12.

19. Hearings on S. 227, cited *supra* n. 13, 46-47, 72, 398 *et seq.*; Hearings on S. 952, cited, *supra* n. 16, 327-8.

Basically, these problems are only phases of the larger chronic problem of trying to raise the standard of living, which has long been, in general, a meager one in Puerto Rico. HANSON AND PEREZ, INCOMES AND EXPENDITURES OF WAGE EARNERS IN PUERTO RICO (1947) contains a detailed statistical treatment of these facts.

A long continued program to stimulate industrialization, through both public and private agencies, has been regarded by many as fundamental to any solution: TUGWELL, THE STRICKEN LAND, 254-55 (1946); TUGWELL, PUERTO RICAN PUBLIC PAPERS, 58-60, 170-72, 231-33 (1945); F. S. Cohen, *Science and Politics in Plans for Puerto Rico*, 3 *Jour. of Social Issues* (1947); Office of Information for Puerto Rico, *Puerto Rican Handbook*, 30 (1947); U. S. Tariff Commission, *The Economy of Puerto Rico*, 26 *et seq.* (1946); Puerto Rico Department of Agriculture and Commerce, *Puerto Rico, Industrial and Commercial* (1938), *id.* (1941).

20. See Stimson, *The Exemption of Property from Taxation in the United States*, 413 *MINN. L. REV.* 413, 419 (1934).

dustry with money collected through taxation is clearly improper.²¹ But when the subsidy takes the form of a tax exemption, it is generally upheld.²²

It is common learning that taxation must be for a direct public purpose, and that if it is not for such a purpose, due process of law is wanting. As stated by Day, J., in *Green v. Frazier*, 253 U. S. 233, 238 (1920) :

"The due process of law clause contains no specific limitation upon the right of taxation in the States, but it has come to be settled that the authority of the states to tax does not include the right to impose taxes for merely private purposes."

Under this rule, public donations to assist in establishing private industrial enterprises are not for a public purpose, and are therefore unconstitutional.²³

A few courts have acknowledged that an industrial tax exemption is, in economic effect, a form of subsidy and should be subject to the same test.²⁴ In *Eyers Woolen Co. v. Gilsum*, 84 N.H. 1, 146 Atl. 511, 64 A.L.R. 1196 (1929), the court holds that a special exemption given by statute to a specific woolen mill is not for a "public purpose" and hence is void, stating (at p. 9 of 84 N.H.) that this exemption "gives the town's money to the plaintiff as effectively as would a direct appropriation of the sum involved."²⁵

An even more emphatic statement is found in *Brewer Brick Co. v. Town of Brewer*, 62 Me. 62, 72, 16 Am. Rep. 395 (1873) :

"It is conceded in the argument that towns and cities cannot constitutionally be authorized to raise by taxation money to be given away. . . . But the remission of a tax by a vote of the town is in substance and effect a gift. What matters it to the plaintiffs or the defendants whether the town votes to give \$309.75 to the plaintiffs, or to exempt their property from its just and proportional tax, and assess the amount of such exemption upon the remaining estate liable to taxation? It is a gift."

However, the leading case of *Crafts v. Ray*, 22 R.I. 179, 46 Atl. 1043, 49 L.R.A. 604 (1900) comes to a different conclusion. Two specific firms had been exempted for ten years by a town vote subsequently ratified by the Rhode Island General Assembly. An argument similar to the one above quoted was made but (at p. 189 of 22 R.I.) was refuted most emphatically :

21. See cases cited *infra* n. 23.

22. See cases cited *infra* n. 26.

23. *Loan Assn. v. Topeka*, 20 Wall. 655 (U. S. 1875) (shops to manufacture iron bridges); *Ferrell v. Doak*, 152 Tenn. 88, 275 S. W. 29 (1924) (box factory); *Minnesota Sugar Co. v. Iverson*, 91 Minn. 30, 97 N. W. 454 (1903) (sugar mills); *Clee v. Sanders*, 74 Mich. 692, 42 N. W. 154 (1889) (stave mill); *English v. People*, 96 Ill. 566 (1880) (rolling mill); *Weismer v. Douglas*, 64 N. Y. 91 (1876) (lumber mill).

24. *Stimson, The Stimulation of Industry Through Tax Exemption*, 11 THE TAX MAGAZINE, 221, 222 (1933); *Baker, Tax Exemption Statutes*, 7 TEX. L. REV. 50, 60 (1928).

25. To the same effect, see *State v. Company*, 60 N. H. 219, 251 (1880) and *Canaan v. District*, 74 N. H. 517, 70 Atl. 250 (1908).

"It is argued that the exemption in this case is equivalent to taking a taxpayer's money, and giving it to the manufacturer. It is not quite that. The theory of the transaction is that a public benefit will accrue to the town and its inhabitants by the introduction of the business enterprise, equivalent to an exemption from taxes for a certain time, and on this ground it is offered. . . . The property of a town is benefited, both in value and income, by the introduction of business, and the consequent increase of inhabitants. When, therefore, one erects a factory under a contract of exemption, the consideration for which is an expected public benefit, the case is quite different from that of a pure gift."

The generally prevailing rule, it seems, is that, where not forbidden by constitutional prohibition, the legislature may validly exempt new industries in general from taxation.²⁶ In *Duke Power Co. v. Bell*, 156 S.C. 299, 152 So. 865 (1930), for example, the court was called upon to construe a statute²⁷ granting a five year exemption from county taxes to new "manufactories." The state constitution (article 10, section 1) authorized exemptions of property "for municipal purposes." It was held that the statute was valid as being for a "municipal purpose," that is, "a public or governmental purpose as distinguished from a private purpose."²⁸

The legislature's exercise of its power to exempt property from taxation must not be arbitrary, but must be founded upon some principle of public policy which will support the presumption that the public interest will be served by the exemption.²⁹

Attacks against industrial exemption laws have been made under several differing constitutional phraseologies. A number of state constitutions require "uniformity" and/or "equality" in taxation, for example. The leading case of *Wisconsin C.R. Co. v. Taylor County*, 52 Wis. 37, 8 N.W. 833 (1881) expounds the accepted doctrine, after an exhaustive survey of earlier authority.³⁰ The state Constitution (art. 8, §1) said that, "The rule of taxation shall be uniform." The conclusion of the court (at p. 95 of 52 Wis.) was that:

"Taxes can only be levied upon such property as the legislature shall prescribe, and then only by a uniform rule, but it is the 'rule,' and not the property, which the constitution thus requires to be 'uniform.' The legislature not only has the power to

26. *Crow v. General Cable Corp.*, 223 Ala. 611, 137 So. 657 (1931); *Duke Power Co. v. Bell*, 156 S. C. 299, 152 S. E. 865 (1930); *Williams v. Baldrige*, 48 Idaho 618, 284 Pac. 203 (1930); *State v. Elba Bank & Trust Co.*, 18 Ala. App. 253, 91 So. 917 (1921); *In Re Auditor General*, 199 Mich. 489, 165 N. W. 771 (1917).

27. 34 SOUTH CAROLINA STATUTES AT LARGE 891 (1925).

28. From syllabus, 156 S. C. at p. 301.

29. *Miller v. Lamar Life Ins. Co.*, 158 Miss. 753, 131 So. 282 (1931); *Harkin v. Bd. of Commrs.*, 30 Wyo. 455, 222 Pac. 35 (1924); *State v. Snyder*, 29 Wyo. 199, 212 Pac. 771 (1923).

30. *Accord*, *People v. The Auditor*, 7 Mich. 84 (1859), where, under a constitutional provision (art. 14, § 11) stating, "the legislature shall provide a uniform rule of taxation," it was held that "this provision of the constitution has no reference to the power to exempt or remit taxes." (7 Mich. at p. 90). See also, *State v. Collins*, 43 N. J. L. 562 (1881).

prescribe the property to be taxed, but the rule by which it is to be taxed; and the only limitation upon that power is that the rule so prescribed shall be uniform. The power to prescribe what property shall be taxed necessarily implies the power to prescribe what property shall be exempt."

A similar theory has been developed elsewhere under similar or more stringent constitutional language. Under a provision³¹ stating that "taxation shall be equal and uniform throughout the state," it was held in *New Orleans v. Fourchy*, 30 La. Ann. 910 (1878) that an exemption was valid, on the theory of reasonable classification.³² The court (at p. 912 of 30 La. Ann.) quoted with approval, from *State v. Poydrus*, 9 La. Ann. 165 (1854), the following words:

"To be uniform, taxation need not be universal. Certain objects may be made its subjects, and others may be exempted from its operation . . . but as between the subjects of taxation in the same class there must be equality."

This rationale demands as the price of validity that the exemption statute must be of general and uniform application. Even under the liberal view, a special exemption of limited application will be invalid for lack of uniformity and equality.³³ Other constitutional provisions less explicit than those above quoted have been held not to invalidate tax exemption statutes.³⁴

The Bill of Rights contained in the Organic Act of Puerto Rico³⁵ provides that "The rule of taxation in Puerto Rico shall be uniform." The federal and Puerto Rican cases construing this provision are in accord with those previously discussed. They hold generally that it demands uniformity only within classifications which the legislature may make, so long as they are not arbitrary.³⁶ Under the authorities, the present statute would be difficult to attack on this ground.

31. LOUISIANA CONST. Art. 118.

32. In reference to an identical clause of the Mississippi Constitution (art. 12, § 20), it was said in *Mississippi Mills v. Cook*, 56 Miss. 40, 60 (1878) that "It does not take away from the Legislature the discretion to select the subjects. But when the selection is made, all property of that sort must bear its proportional part of the burden."

See also *New Orleans v. Kaufman*, 29 La. Ann. 283, 29 Am. Rep. 328 (1877), where the court states that "the constitutional provision that taxes shall be equal and uniform does not prevent the legislature, or any municipal corporation authorized thereto by the legislature, from dividing the objects of taxation into different classes, and imposing different taxes on each class. It merely requires that the tax on each member of the same class shall be the same."

A similar result was reached in *Kitanning Coal Co. v. Commonwealth*, 79 Pa. St. 100 (1875) under a clause (PA. CONST. Art. 9, § 1) requiring that "all taxes shall be uniform upon the same class of subjects."

33. *Brewer Brick Co. v. Town of Brewer*, 62 Me. 62, 16 Am. Rep. 395 (1873).

34. *Crafts v. Ray*, 22 R. I. 179, 46 Atl. 1043 (1900), where art. I, § 2 of the state constitution said that "the burdens of the state ought to be fairly distributed among its citizens"; and *Colton v. Montpelier*, 71 Vt. 413, 45 Atl. 1039 (1899), where art. 9 of the Vermont Bill of Rights declared that every member of society is bound to contribute his proportion towards the expense of the protection of life, liberty, and property.

35. 39 STAT. 951 (1917), 48 U. S. C. § 737.

36. *Ballester-Ripoll v. Court of Tax Appeals of Puerto Rico*, 142 F. 2d 11 (C. C. A. 1st 1944); *Revera v. Buscaglia*, 146 F. 2d 461 (C. C. A. 1st 1944); *Flores Alvaroz & Company v. Gallardo*, 36 P. R. 105).

An attack on the statute, based upon the due process and equal protection clause, probably also would be of dubious efficacy. The Supreme Court of the United States has not extended the public purpose doctrine into the field of tax exemptions. Mr. Justice Bradley, speaking for a unanimous court in *Bell's Gap R. Co. v. Pennsylvania*, 134 U. S. 232, 237 (1890), laid down the rule thus:³⁷

"The provision in the fourteenth amendment, that no state shall deny to any person within its jurisdiction the equal protection of the laws, was not intended to prevent a state from adjusting its system of taxation in all proper and reasonable ways. It may, if it chooses, exempt certain classes of property from any taxation at all. . . . We think we are safe in saying that the fourteenth amendment was not intended to compel the states to adopt an iron rule of equal taxation. If that were its proper construction, it would . . . render nugatory those discriminations which the best interests of society require; which are necessary for the encouragement of needed and useful industries, and the discouragement of intemperance and vice, and which every state, in one form or another, deems it expedient to adopt."

REVOCABILITY OF EXEMPTIONS. POSSIBLE AMENDMENTS

The law here under discussion represents a conciliatory gesture by the Puerto Rican Legislature toward businessmen from the North. There has been considerable agitation in the past against "absentee capitalists." But the present regime is characterized by friendliness toward outside business interests. The governments of the Island have generally had a truly "American" sense of public moral responsibility. There is no ground for fearing that these tax exemptions will be repealed before they expire by their terms. However, it is fairly well settled that general exemptions conferred by statute do not create contractual rights immune from subsequent impairment, even where persons have acted in reliance thereon.³⁸ Therefore, it is possible that the law should be amended to protect entrepreneurs fully against premature amendment or repeal. Already such changes are under discussion.

The leading case on the question of revocability is *East Saginaw Mfg. Co. v. East Saginaw*, 80 U.S. (18 Wall.) 373 (1871) affirming 19 Mich. 259, 2 Am. Rep. 82 (1869). The statute there under consideration was for the encouragement of salt manufacturing in Michigan. Originally having enacted (in 1859) an unlimited exemption from taxation for all property so utilized,³⁹

37. For similar language in reference to Puerto Rico, see *Monllor & Boscio v. Sancho*, 136 F. 2d 114 (C. C. A. 1st 1943). Note also that decisions dealing with the validity of state laws under the 14th Amendment to the United States Constitution are applicable in determining the validity of Puerto Rican laws under the Organic Act: *Roig v. Puerto Rico*, 147 F. 2d 87 (C. C. A. 1st 1945).

38. *East Saginaw Mfg. Co. v. East Saginaw*, 19 Mich. 259, 2 Am. Rep. 82 (1869), *aff'd*, 13 Wall. 373 (U. S. 1871); *City of Springfield v. Smith*, 138 Mo. 645, 40 S. W. 757 (1897); *Bank of Owensboro v. Daviess Co.*, 102 Ky. 174, 39 S. W. 1030 (1897). In *Shiner v. Jacobs*, 62 Iowa 392, 17 N. W. 613 (1883), an exemption given on account of the planting of trees was held repealable even as to one who had planted trees in reliance thereon.

39. Act of Feb. 15, 1859.

the legislature subsequently limited the exemption to five years.⁴⁰ The company sued to enjoin taxation after the five year period had expired. It alleged that it had been formed and had engaged in the manufacturing of salt solely in reliance upon "the encouragement held out in said act." On a demurrer by which the truth of this allegation was admitted, the bill was dismissed. The United States Supreme Court, speaking unanimously, again per Bradley, J., (at p. 378 and 379 of 80 U.S.) twice emphasized the fallacy in plaintiff's argument:

"It is a general law, regulative of the internal economy of the State, and as much subject to repeal and alteration as a law forbidding the killing of game in certain seasons of the year. Its continuance is a matter of public policy only; and those who rely on it must base their reliance on the free and voluntary good faith of the legislature."

"General encouragements, held out to all persons indiscriminately, to engage in a particular trade or manufacture, whether such encouragement be in the shape of bounties or drawbacks, or other advantage, are always under the legislative control, and may be discontinued at any time."

On the other hand, where there is a bargain for consideration, the exemption will not be subject to impairment by subsequent legislation.⁴¹ A typical situation where such a contract is found to exist is where the exemption is contained in a corporate charter.⁴² However, even in circumstances considerably less clear than this, a few cases have found a valid contract to exist. In *Caverly-Gould Co. v. Village of Springfield*, 83 Vt. 396, 76 Atl. 39 (1910), pursuant to an enabling act (Vt. Stats. § 365), the defendant town had by vote granted an exemption to the petitioner. The case, says the court (at p. 402 of 83 Vt.)

"is to be governed by the contract between the town and the orator, evidenced by the offer made by the vote of March 26, 1898, and its acceptance by the orator. The vote was to exempt from taxation for 10 years all manufacturing establishments investing a capital of over \$5000 that might be established and put in operation during the then next 12 months. This was the offer, and the orator accepted it by complying with its requirements in every particular therein expressed."

The result was then plain:

40. Act of March 15, 1861.

41. U. S. CONST. ART. I, § 19. The Organic Act for Puerto Rico states similarly that "No law impairing the obligation of contracts shall be enacted." 39 STAT. § 951 (1917), 48 U. S. C. § 737. See 2 COOLEY, TAXATION § 701 (4th ed. 1924); Baker, *op. cit. infra* n. 43 at p. 236.

42. These instances were quite frequent prior to the development of modern incorporation statutes. For example, some sixty statutes granting exemptions to specifically named enterprises were passed by the New Hampshire Legislature, usually in the form of corporate charters, between 1805 and 1820. See *Eyers Woolen Co. v. Gilsum*, 84 N. H. 1, 19, 146 Atl. 511 (1929).

"We hold, therefore, that the vote here was authorized by the statute, and that the town was bound by it when the orator acted upon it, as it did, with a view to the exemption."

This case is clearly an exceptional one⁴³ and in general no contractual relationship will be found, except where there exists express statutory language creating such a relationship,⁴⁴ or equivalent circumstances clearly indicative of intent to create a binding contract.⁴⁵ The generally accepted rule is that stated by the Connecticut court in *State ex rel. Foote v. Bartholomew*, 108 Conn. 246, 247, 142 Atl. 800, 803 (1928) :

"In order to give a statute granting an exemption such a contractual nature that it may not be repealed, it is necessary in the first place that there be a clear intent to create something more than a mere privilege or bounty, repealable at the will of the legislature. . . . To give to a tax exemption the nature of a contractual obligation it must be supported by a consideration. . . . Finally, it is to be remembered that to give to a tax exemption the effect of a contractual obligation is to limit the power of the Legislature to mould legislation to meet the needs of the varying circumstances of the times and inevitably to produce inequalities in tax burdens. Such a result is to be avoided if it can be by any reasonable intentment. "

CONSTRUCTION AND INTERPRETATION

The theory of strict construction⁴⁶ followed in the cases cited above is generally also followed by the courts in considering other aspects of tax exemption laws.⁴⁷ In analyzing the present Puerto Rican statute, it may be

43. COOLEY, *LAW OF TAXATION*, § 702 (4th ed. 1924); Zumbalen, *The Federal Constitution and Contract Exemptions from Taxation*, 17 ST. LOUIS L. REV. 191 (1932); Many of the cases are collected in Baker, *Some Questions Raised in the Field of Tax Exemption*, 8 TEXAS L. REV. 196, 235 n. 256 (1930). See also, Colby, *Exemption from Taxation by Legislative Contract*, 13 AMER. L. REV. 26 (1878).

44. See N. H. Laws of 1860, ch. 2361: "All manufacturing establishments . . . are exempted from taxation for ten years after the passage of this act; provided towns and cities in which such manufacturing establishments may be located . . . shall . . . give their assent to such exemption; and such assent shall have the force of a contract." That such a legislative contract is binding, see *Dow v. Railroad*, 67 N. H. 1, 49, 52 (1886), and *In Re Opinion of the Justices*, 261 Mass. 523, 553, 159 N. E. 55 (1928), where in construing a similar clause, the court said, "The sovereign power itself may in certain conditions for the public welfare make a binding contract as to exemptions from taxation."

45. See *Portland v. Portland Water Co.*, 67 Me. 135, 136 (1877): "Here the action of the legislature, with the vote of the city in pursuance of it, partakes the character of a contract with the defendant corporation. The consideration for a contract on the part of the city is palpable. The defendants are obliged to furnish without expense to the city, all the water for its public buildings and school-houses, and for the extinguishment of fires, that may be needed therefor; and the defendants are also under considerable obligations to the city and state."

46. The basis of the rule is set forth in COOLEY, *op. cit. supra* n. 43, §§ 672-74. See also, COOLEY, *op. cit. supra* n. 43, *passim*, and Baker, *op. cit. infra* n. 47.

47. See, for example, *Waller v. Hughes*, 2 Ariz. 114, 11 Pac. 122 (1886), construing a tax statute so as not to exempt mines or mining claims; and *Hart v. Plum*, 14 Cal. 148 (1859), holding that an exemption of mining claims does not include the flumes leading thereto. Baker, *Judicial Interpretation of Tax Exemption Statutes*, 7 TEX. L. REV. 385 (1929), analyzes the problems and possibilities of judicial construction in this field, showing how the tax structure may be affected by adoption of either loose or strict construction principles. See also, Baker, *op. cit. supra* n. 43 at pp. 226-31.

of value to investigate cases interpreting other industrial tax exemption laws, with a view to determining to what extent its provisions obviate problems of judicial interpretation encountered elsewhere.

The definition of an industry qualified for exemption in Puerto Rico commences in terms of "methods of processing and manufacture, either by hand or by machinery." Most industrial tax exemption statutes have defined the benefited parties in terms of "manufacture" or "manufacturing." An extensive case law has developed construing these somewhat inexact words in reference to specific enterprises. A number of cases indicate in the usual terms that the determinative factor is the legislative intent or purpose;⁴⁸ others rely on a physical or functional test as applied to the conduct of the business;⁴⁹ and still others look to the end result as conclusive.⁵⁰ Each case must be determined on its own facts. The problem has been well stated in *Louisville v. Zimmoester and Sons*, 188 Ky. 570 at 576, 222 S.W. 958, 10 A.L.R. 1269 (1920):⁵¹

"Courts have experienced much difficulty in determining what is a manufacturing establishment, and what is included in the term "manufacture." There is no hard and fast rule by which to determine whether a given establishment is a "manufacture," but all the facts and circumstances must be taken into consideration in determining whether the establishment is or is not to be so reckoned. Whether it is such an establishment does not depend upon the size of the plant, the number of men employed, the nature of the business, or the article to be manufactured, but upon all these together and upon the result accomplished.

"If raw material is converted at a factory or plant into a finished product, complete and ready for the final use for which it is intended, or so completed as that in the ordinary course of business of the concern it is ready to be put upon the open market for sale to any person wishing to buy it, the plant which turns it out is a manufacturing establishment within the meaning of the statutes."

The present Puerto Rican statute to some extent avoids these difficulties of construction. It provides that, to qualify for exemption, enterprises must "have as their object the production, in Puerto Rico, of articles of commerce." It actually lists a large number of articles of commerce which it would presumably be feasible to manufacture on the Island. In the case of such articles, at least, the scope of the words "processing and manu-

48. *Carroll County v. B. F. Shriver Co.*, 146 Md. 412, 126 Atl. 71 (1924). *Cf.* *Neuhoff Packing Co. v. Sharpe*, 146 Tenn. 293, 240 S. W. 1101 (1921).

49. *H. M. Rowe Co. v. State Tax Commissioner*, 149 Md. 251, 131 Atl. 509 (1925), ruling that manufacture means "the process of converting some material into a different form adapted to uses which in its original form it could not be so readily adapted, and is associated nearly always with the use of manual or mechanical energy . . ."; *Commonwealth v. Weiland Packing Co.*, 292 Pa. St. 447, 141 Atl. 148 (1928), defining manufacture to mean "the production of some new article"; *Dolese & S. Co. v. O'Connell*, 257 Ill. 43, 100 N. E. 235 (1912) (*semble* to *Weiland* case).

50. *P. Lorrillard Co. v. Ross*, 183 Ky. 217, 209 S. W. 39 (1919), ruling that the determination turns upon whether there is a finished product fit for commercial use; *State v. Gardner & J. Co.*, 176 La. 221, 145 So. 521 (1933), using a test based on the creation of a physical product of "appreciable" durability.

51. *Cf.* *Lexington v. Lexington Leader Co.*, 193 Ky. 107, 235 S. W. 31 (1921).

facture" is not likely to be troublesome. The only question of statutory interpretation before the Council will presumably be whether the finished product is among those enumerated.⁵²

Difficulties have been encountered under statutes prescribing that the applicant must be organized or operating exclusively for manufacturing purposes. Where the statute contains this requirement,⁵³ the courts have sometimes looked to the charter, rather than to the business actually being conducted, to determine whether the applicant qualifies for tax exemption.⁵⁴ The rule of strict construction prevails here as elsewhere.⁵⁵ Thus, a corporation organized to operate a distillery and also to engage in feeding livestock is not exempt, for the latter purpose is not manufacturing.⁵⁶ By

52. By expressly including production "by hand" within its terms, Act No. 346 avoids the problem sometimes encountered of a court adopting the etymologically unsound position that the use of extensive machinery is a significant criterion of "manufacturing." See, for example, *State v. American Sugar Refining Co.*, 108 La. 603, 32 So. 965 (1902), where, largely on the ground that extensive machinery was being employed, a sugar refining plant was held entitled to a manufacturing exemption. This case expressly overruled a previous case on the same facts and under the same style, holding to the contrary: 51 La. Ann. 562, 25 So. 447 (1898).

The usual rule is that the use of expensive and complicated machinery is not a determining factor: *Commonwealth v. Sunbeam Water Co.*, 284 Pa. St. 180, 130 Atl. 405 (1925) (distilling of water); *Commonwealth v. Glendora Products Co.*, 297 Pa. St. 305, 146 Atl. 896 (1929) (roasting coffee). Compare *State v. American Biscuit Co.*, 47 La. Ann. 160, 16 So. 750 (1895) (*Held*: exemption for manufacturing obtains where crackers and biscuits are produced on a large scale by machinery.)

53. Pennsylvania Act of June 1, 1889, P. L. 420, as supplemented, 72 P. S. § 1892: "actually and exclusively employed in . . . manufacturing." This statute is construed in *Commonwealth v. Paul W. Bounds Co.*, *infra* n. 55. See also the Illinois statute (2 STARR & C. ANN. STAT. p. 2032) construed in *Distilling & Cattle Feeding Co. v. People*, *infra* n. 56, which has the terminology, "organized for purely manufacturing purposes."

54. *Commonwealth v. J. B. Lippincott Co.*, 156 Pa. St. 513, 27 Atl. 10 (1893). In *Commonwealth v. Filbert Paving & Construction Co.*, 229 Pa. St. 231, 234, 78 Atl. 104 (1910), the court says, "the company was incorporated for manufacturing purposes and has a prima facie right under its charter to do a manufacturing business. While the purpose stated in the charter is not conclusive of the nature and character of the business to be transacted, it does primarily indicate the purpose for which the corporation is created . . . the burden rests upon those who challenge the primary purpose stated in the certificate of incorporation to show that it is something different."

55. "Where a corporation is not organized for manufacturing, whether it is doing manufacturing or not, it is not entitled to any manufacturing exemption." *Commonwealth v. Paul W. Bounds Co.*, 316 Pa. St. 29, 31, 173 Atl. 633 (1934). *Accord*, *Commonwealth v. Westinghouse Electric & Mfg. Co.*, 151 Pa. St. 265, 24 Atl. 1107 (1892).

The use of the word "manufacturing" in the articles of incorporation is not conclusive: *Commonwealth v. Arrott Mills*, 145 Pa. St. 69, 22 Atl. 243 (1891) (corporation chartered to manufacture steam held not exempt on ground it was "not a manufacturer or producer of anything."); *Commonwealth v. Wark Co.*, 301 Pa. St. 150, 151 Atl. 786 (1930) (corporation chartered to engage in "the manufacture of buildings and structures" held not exempt); and *Commonwealth v. Philadelphia Coca-Cola Bottling Co.*, 15 Pa. D. & C. 254 (1930) (corporation chartered "to manufacture . . . carbonated waters, syrups and beverages" held not engaged in manufacturing, hence not exempt).

Where the statute requires the applicant to be "wholly engaged in carrying on manufacture within the state," if any part of the manufacturing is done elsewhere, the exemption does not obtain: *People ex rel. American Soda Fountain v. Roberts*, 158 N. Y. 168, 52 N. E. 1104 (1899); *People ex rel. Schwarzschild & S. Co. v. Roberts*, 11 App. Div. 449, 42 N. Y. Supp. 317 (1896), *aff'd*, 156 N. Y. 690, 50 N. E. 1121 (1898). See also *People ex rel. Seth Thomas Clock Co. v. Wemple*, 133 N. Y. 323, 31 N. E. 238 (1892).

56. *Distilling & Cattle Feeding Co. v. People*, 161, Ill. 101, 43 N. E. 779 (1896). But see *Dolese & S. Co. v. O'Connell*, 257 Ill. 43, 100 N. E. 235 (1912), where a corporation organized to manufacture building materials and to construct roads, was held exempt

defining "new industry" in terms of the article produced, the Puerto Rican act presumably avoids these problems.

A few cases have set forth a special rule to the effect that a corporation which, pursuant to charter powers, engages in a non-manufacturing enterprise related and incidental to the manufacturing business, is nevertheless entitled to an exemption on property employed in the latter category, for the auxiliary activity does not affect the "exclusive" nature of the manufacturing business.⁵⁷ Act No. 346 contains no restrictive language of this sort. The act as a whole seems to indicate that any person, natural or artificial, may embark upon "new industry" production, regardless of whether non-exempt manufacturing is now proceeding, and qualify thereby for tax exemption. This conclusion is borne out by the statutory language limiting the scope of the exemption to "such property as, in the judgment of the Executive Council, is necessary for the development, organization, construction, establishment, and operation of said new industry,"⁵⁸ to "the income which the applicant may derive from the exploitation of said industry";⁵⁹ and to license taxes, fees or other imposts upon "the exploitation and operation of any feature of said new industry."⁶⁰ When it is recalled that "new industry" is largely defined in terms of the article produced, it becomes clearly possible for the exemption to apply to one or more parts of a larger industrial enterprise.⁶¹

These same considerations would seem to permit exemption to be conferred upon persons engaged in a "new industry" even where the same is incidental or auxiliary to a non-exempt activity. This is true under the

where the latter charter power was never exercised. But, *contra*, where the secondary power is exercised: *People ex rel. Syracuse Improvement Co. v. Morgan*, 59 App. Div. 302, 69 N. Y. Supp. 263 (1901).

57. *Commonwealth v. Juniata Coke Co.*, 157 Pa. 507, 27 Atl. 373 (1893) (mining coal to use in business of manufacturing coke); *Commonwealth v. Savage Fire Brick Co.*, 157 Pa. 512, 27 Atl. 374 (1893) (mining clay to be used in business of manufacturing fire bricks, tiles, etc.); *People ex rel. Tiffany & Co. v. Campbell*, 154 N. Y. 166, 38 N. E. 990 (1894) (corporation empowered to manufacture gold and silverware, and to engage in distribution and sale of its own products). But compare *People ex rel. Western Electric Co. v. Campbell*, 145 N. Y. 587, 40 N. E. 239 (1895), where a corporation chartered to engage in the mercantile buying and selling of electrical equipment generally, as well as to manufacture such articles, was held not exempt.

58. Section 2(a).

59. Section 2(b).

60. Section 2(c).

61. This construction avoids results often reached under other tax exemption statutes. A number of cases hold that the expansion of an existing plant, or the building of a new and larger one, even where the purpose is to produce a new line, or a greater variety, of articles, does not constitute the establishment of a "new industry" within the meaning of the tax exemption statute: *Louisville v. Louisville Tin & Stove Co.*, 170 Ky. 557, 186 S. W. 124 (1916) (small tin shop replaced by a large factory using much machinery to produce many new articles); *Mengel Box Co. v. Sea*, 167 Ky. 193, 180 S. W. 347 (1915) (new plant added to wooden box factory in order to produce paper boxes); *B. F. McCormick Lumber Co. v. Winchester*, 155 Ky. 494, 159 S. W. 997 (1913) (planing mill producing for the wholesale market enlarged and improved in order to begin producing for the retail market); *Tallassee Mfg. Co. v. Spigener*, 49 Ala. 262 (1873) (cotton factory with 4,000 spindles enlarged by the addition of new buildings operating 14,000 spindles).

Puerto Rican law although the cases indicate that a contrary result is more usual under many industrial tax exemption statutes.⁶² Since production on a "commercial scale" is all that is asked for,⁶³ the rationale of *Illinois Central R. Co. v. Paducah*, 228 Ky. 65, at p. 70, 14 S.W. 2d 172 (1929)⁶⁴ would seem particularly apropos here:

"If the purpose was to encourage manufacturing, then that purpose is attained when a person, firm, or corporation engaged in manufacturing, although not exclusively so, and although incidentally to some other business carried on by him or it. The pay rolls are the same, the labor afforded is the same—in fact, all the benefits . . . are the same."

A possible difficulty, but not a serious one, in determining what is a "new industry" in Act No. 346 is found in the words "raw materials." In order to qualify for the exemption, the applicant must intend to engage, or be engaged, in such a method of processing and manufacture "as shall, by transforming raw materials," have as its object the production of certain described articles of commerce.⁶⁵ If this term were defined strictly (i.e. the basic materials in their natural state) the act would be practically nullified; except for its agricultural lands, Puerto Rico has few known natural resources.⁶⁶

Most of the articles in the enumeration of § 1(c), however, are produced from previously semi-fabricated materials.

Unnecessary violence to the obvious legislative purpose would be done if a strict definition of "raw materials" were emphasized as a limitation upon the force of the enumeration and description of exempt products.⁶⁷ The use of the term need not be rejected as pure surplusage, but should be relegated to a position of relative unimportance in all but the most extreme cases. The deletion from the definition of the limiting proviso found in the 1936

62. *People ex rel. New England Dressed Meat & Wool Co. v. Roberts*, 155 N. Y. 408, 50 N. E. 53 (1898) (fertilizer manufactured incidental to slaughterhouse); *Commonwealth v. Keystone Laundry Co.*, 203 Pa. St. 289, 52 Atl. 326 (1902) (soaps and dyes produced incidental to a laundry); *State ex rel. Ernst v. State and City Board*, 36 La. Ann. 347 (1884) (rice flour manufactured incidental to rice milling does not qualify the miller for an exemption given to flour manufacturers). *Contra: Illinois Central R. Co. v. Paducah*, 228 Ky. 65, 14 S. W. 2d 172 (1929) (manufacture of engine and car parts incidental to railroad business).

63. See § 1 (b) and the proviso following § 1 (c). For cases where the volume of business was a factor considered in determining whether the applicant was engaged in manufacturing so that a tax exemption law applied, see *Hughes & Co. v. Lexington*, 211 Ky. 596, 277 S. W. 981 (1925) (food products); *Commissioners of Carroll County v. Shriver Co.*, 146 Md. 412, 126 Atl. 71 (1924) (food products); and *Baltimore v. State Tax Commission*, 161 Md. 234, 155 Atl. 739 (1931) (machinery and metal products).

64. In this case, tax exemption was held to apply to a corporation engaged in the manufacture of engine and railroad car parts incidental to a railroad enterprise.

65. Section 1.

66. See 22 *Encyc. Americana* 401 (1939); 18 *Encyc. Brit.* 261 (14th ed. 1938); *Hearings on S. 952, supra* n. 16, p. 155, 202.

67. A strict interpretation is fully justifiable where the statute specifies the raw material to be used. Under a law exempting from taxation enterprises manufacturing "paper and paper products out of wood pulp," a factory making paper bags out of kraft

statute (quoted *supra*, p. 2) indicates that this was the intention of the legislature.

Some support for this position may be found in the authorities. Under a Kentucky statute conferring exemption from taxation upon raw materials in the process of manufacture, the following gloss has been placed upon the words:⁶⁸

"By the term 'raw material,' as used in the statute, is not necessarily meant crude material in its natural state, but there may be included in the term a product made from the crude material, and which has undergone manufacturing processes and been converted into a distinct product from which an entirely different one may be made by the application of additional scientific processes, in which case the converted or prepared material may be regarded as 'raw material' within the meaning of the statute."

Scientific progress is constantly shifting the panorama of industrial processes; this concept of "raw materials" must necessarily be a dynamic rather than a static one.⁶⁹ In Act No. 346 it is probably meant only to exclude from the exemption those enterprises which do not add some substantial new value, form, shape, or utility to the materials subjected to "processing and manufacture."⁷⁰ As recently stated by the Kentucky court,⁷¹

"'Raw material' is susceptible of no definite and all inclusive definition and this term must be interpreted as it is commonly understood by all mankind and in the sense in which it was used by the Legislature and the purpose it sought to accomplish."

Occasionally, the qualifications of an applicant for tax exemption are questioned on the ground that he is not actively engaged in the business exempted. Where an abandonment of the business has occurred, the status of

paper made from wood pulp by another concern is not exempt: *Pineland Bag Co. v. Riley*, 142 Miss. 574, 107 So. 554 (1926). *Cf.* *Cohn v. Parker*, 41 La. Ann. 894, 6 So. 718 (1889), where it was held that a producer of clothing out of already manufactured cloth was not within an exemption to manufacturers of "textile fabrics."

68. *Henderson v. George Decker Co.*, 193 Ky. 248, 257, 235 S. W. 732 (1921). *Accord*, *Louisville v. Louisville Tin & Stove Co.*, *supra* n. 61.

69. See Note, *Raw Materials*, 13 ENCYC. SOC. SCIE. 123, 124 (1934). In *Todd Co. v. Bond Bros.*, 300 Ky. 224, 188 S.W. 2d 325 (1945) where fully sawed and shaped railroad ties were held to be raw materials of a creosoting plant, the court said: "A number of years ago the creosoting process of ties was generally unknown, and . . . during that time the railroad tie was completely manufactured when it left the saw mill, but under the modern processing, such ties are not completed, or ready for the use intended, nor made into a saleable product until after the final chemical treatment." (188 S. W. 2d at 328). For a contrary view, in an earlier industrial climate, on the same facts, see *Shreveport Creosoting Co. v. Shreveport*, 119 La. 637, 44 So. 325 (1907).

70. See *Norris v. Commonwealth*, 27 Pa. St. 494 (1856) where the court remarked that manufacturing "does not often mean the production of a new article out of materials wholly raw. It generally consists in giving new shapes, new qualities, or new combinations to matter which has already gone through some other artificial process."

71. *Stearns Coal & Lumber Co. v. Thomas*, 295 Ky. 808, 810, 175 S. W. 2d 505 (1943).

"manufacturer" no longer exists, and a pre-existing exemption is terminated.⁷² On the other hand, a temporary suspension of business for a reasonable time because of some legitimate business exigency, where not amounting to abandonment, will not normally end the exemption.⁷³ Act No. 346 eliminates uncertainty on this point by conferring discretion directly upon the Executive Council, with the Governor's approval, to revoke an exemption, "if the natural or artificial person, to whom the benefit of the exemption has been granted . . . discontinues production, on a commercial scale, of such article or articles of commerce, and fails to resume such production within the period or periods fixed for him by the Executive Council of Puerto Rico for the purpose."⁷⁴

Under statutes requiring the applicant to be "actually engaged" in manufacturing, where the applicant is not the operator but only the owner-lessor of a plant, the cases are in conflict. It has been held that the owner of the plant is not entitled to exemption after leasing it, even though the same type of manufacturing is carried on by the lessee.⁷⁵ Even under a statute which authorized municipalities to grant exemptions to "any manufacturing *establishment*" and "the *capital* to be used in operating the same," the New Hampshire court managed to hold the lessor not entitled to the exemption.⁷⁶

On the other hand, a very strong argument has been used to support a contrary holding:⁷⁷

"The primary object of this statute is, not to aid and benefit private persons for private ends, but its purpose is to benefit the public at large by increasing, in the end, the resources of the state and its taxable property through the establishment of new industries."

72. *Electric Traction Co. v. New Orleans*, 45 La. Ann. 1475, 14 So. 231 (1893); *State, Edison Phonograph Co., Pros. v. State Assessors*, 55 N. J. L. 55, 25 Atl. 329 (1892).

73. *Bradford v. Mote*, 2 Marv. (Del.) 159, 42 Atl. 445 (1895) (organ plant suspended operations because of lack of funds); *Waterbury v. Atlas Steam Cordage Co.*, 42 La. Ann. 723, 7 So. 783 (1890) (*held*, exemption continues for period during which closed down "for prudential reasons, on account of the high price of hemp," but not during period when plant was leased and closed down by the lessee "for the purpose of stopping competition and reducing the supply of rope.")

74. Section 6.

75. *Felippe A. Broadbent Mantel Co. v. Baltimore*, 134 Md. 90, 106 Atl. 250 (1919). The holding of *Commonwealth v. Macungie Iron Co.*, 9 Pa. Dist. Rep. 477 (1891), in accord, was later nullified by legislation expressly stating that a lease does not cause the lessor to lose its tax exemption: Act of July 11, 1901, quoted in *Commonwealth v. Cambria Iron Co.*, 5 Dauphin Co. Rep. (Pa.) 101 (1902).

76. "If the mere use of the property, without regard to its ownership, had been intended to be the test to determine whether it could be exempted under the statute, it would be natural to expect more explicit language indicating such a purpose." *Portsmouth Shoe Co. v. Portsmouth*, 74 N. H. 222, 66 Atl. 1045 (1907). *Accord*, *State ex rel. Ward v. Board of Assessors*, 46 La. Ann. 859, 15 So. 384 (1894).

77. *Colton v. Montpelier*, 71 Vt. 413, 417, 45 Atl. 1039 (1899). *Accord*, see *Caverly-Gould Co. v. Village of Springfield*, 83 Vt. 396, 76 Atl. 39 (1910), where the lessee had been previously engaged in a different established business not entitled to exemption.

"This end is as effectually attained by the erection of such establishment and buildings and the furnishing of such machinery and appliances, to be used and operated by tenants, as would be the case were the same used and operated for a like purpose by the owner thereof. Without the opportunity to rent such plants, it is apparent that persons with capital sufficient to carry on a successful business therein, but unable financially to erect such plants, would be deterred from engaging in manufacturing, while with an opportunity to rent they would develop new industries. On the other hand, it is conceivable that capitalists might take the risk of building a manufacturing plant; if they could rent the same, and take the benefit of the exemption for a time, when they would not make the investment were they compelled to operate it themselves in order to have the benefit of such exemption."

Act No. 346 is inconclusive on this subject. The Executive Council is authorized, upon notice and hearing and with the Governor's approval, to revoke an exemption "when, without the authorization of the Executive Council or of the Governor of Puerto Rico, the person who obtained the exemption transfers to another the control or possession of the personal property or the machinery used by him for the production of the article or articles listed in his application for exemption."⁷⁸ The implication here seems to be that the exemption will continue in effect unless terminated administratively. But this is not a reliable assumption and an exempt manufacturer would do well not to lease out his manufacturing properties without authorization.

A few cases have held that assembly plants were not entitled to tax exemptions because they were not engaged in manufacturing.⁷⁹ Under a Louisiana constitutional provision exempting plants manufacturing "articles of wood,"⁸⁰ a barrel assembly plant was not qualified, largely because, in the court's opinion, it merely put together previously manufactured articles.⁸¹ Other cases, however, recognize that manufacturing:

"does not often mean the production of a new article out of materials entirely raw. It generally consists in giving new shapes, new qualities, or new combinations to matter which has already gone through some artificial process."⁸²

78. Section 6(4).

79. *People ex rel. Seth Thomas Clock Co. v. Wemple*, 133 N. Y. 323, 31 N. E. 238 (1892); *People ex rel. John A. Roebling's Sons' Co. v. Wemple*, 138 N. Y. 582, 34 N. E. 386 (1893); *Brooklyn Cooperage Co. v. New Orleans*, 47 La. Ann. 1314, 17 So. 804 (1895); *Chickasaw Cooperage Co. v. Police Jury*, 48 La. Ann. 523, 19 So. 476 (1896); *Lake Bros. v. Guilloite*, 48 La. Ann. 870, 19 So. 924 (1896).

80. ART. 207, LOUISIANA CONST. OF 1879.

81. *Brooklyn Cooperage Co. v. New Orleans*, *supra* n. 80, followed in *Chickasaw Cooperage Co. v. Police Jury*, *supra* n. 80. Compare *Henderson v. George Decker Co.*, 193 Ky. 248, 235 S. W. 732 (1921), where the uphostering and assembly of buggies was held exempt, the court saying: "If defendants in the two instant cases were engaged in only a technical assembling of the vehicles . . . we would not be inclined to characterize them as manufacturers . . . But, under the agreed facts, we think there can be no doubt that they are engaged in something requiring more mechanical processes and efforts than the mere act of assembling already finished and completed parts."

82. *Norris Bros. v. Commonwealth*, 27 Pa. St. 494, 496 (1856) (assembling locomotives). Compare *Louisville v. Louisville Tin & Stove Co.*, *supra* n. 61 (assembling

Act No. 346 expressly includes assembly plants within the definition of new industries⁸³ subject to certain qualifications:

"By assembly plants shall be understood those factories engaged in the production of articles of commerce, excluding furniture, by putting together the parts, provided the cost of the work of assembling the article represents such a substantial part of the total cost of the article that in the opinion of the Executive Council the industry deserves the exemption herein provided."

This qualification appears to be based on the same rationale as the majority of the cases. The economic value of the assembling operation has been a significant factor in determining whether an exemption is applicable.⁸⁴ No definite rules can be formulated as to how large must be the added cost in order to be deemed "substantial" by the Executive Council. The decision is expressly left within the bounds of its discretion.⁸⁵ At any rate, the act permits a presumptively final determination of the question in advance and without resort to the courts.

A question arises occasionally whether a manufacturing corporation which causes all or part of its business to be done by contractors is entitled to an industrial tax exemption. Under statutes exempting "manufacture," the rule of the cases seems to be that where all, or most, of the manufacturing is contracted for, leaving none, or only a negligible part of the process to be done by the applicant, the exemption does not obtain.⁸⁶ Only one case

of stoves and other metal articles held to be manufacturing, where part of the materials were previously manufactured, and part were raw); *New Orleans v. LeBlanc*, 34 La. Ann. 596 (1882) (coopers making barrels in part from raw materials held exempt).

83. Section I (c) (36).

84. *Cases holding assembly plant not exempt*: *Lake Bros. v. Guillotte*, *supra* n. 80, where the court said, "The work in Louisiana is infinitesimal as compared with the work elsewhere on the different articles."; *People ex rel. Seth Thomas Clock Co. v. Wemple*, *supra* n. 80, where the court ruled that "A manufacturing corporation of another state cannot bring its products here, and by putting the several parts together and adjusting them to each other, or by performing upon the article some slight operation, though it may involve labor that may be necessary before using it or exposing it for sale and thereby entitle to exemption from taxation on the ground that it is carrying on manufacturing within the state."; and *People ex rel. John A. Roebling's Sons' Co. v. Wemple*, *supra* n. 80, where the court found that the applicant's operations "consist of some additional incidental work to its manufactured products sent here from the other state where its actual manufacturing operations are . . . carried on."

Case holding assembly plant exempt: *People ex rel. L. E. Waterman Co. v. Morgan*, 48 App. Div. 395, 63 N. Y. Supp. 76 (1900), where the court says, "this work creates an integral fountain pen which is four times more valuable than the parts purchased."

85. It is interesting to note that in one case, where from the facts it appears that the cost of assembly was about 50% of the total cost of production, the assembly plant was nevertheless held not exempt: *Chickasaw Cooperage Co. v. Police Jury*, *supra* n. 80.

86. *People v. Horn Silver Mining Co.*, 105 N. Y. 76, 11 N. E. 155 (1887) (no manufacturing exemption where all refining of ore was done by contractor). In *Commonwealth v. Williamsport Rail Co.*, 250 Pa. St. 596, 95 Atl. 795 (1915), the court, by a per curiam opinion, approved the holding in the court below that "buying raw material and sending the same to a company owning a plant, and paying that company an agreed price to shape the raw material into a manufactured product, is not carrying on the business of manufacturing within the state."

has been found where, under these circumstances, the contractor was held entitled to the exemption.⁸⁷

The question may be important as it affects needlework. "Embroidery" is one of the articles in the specifically exempted class.⁸⁸ The production of needlework (including embroidery) in Puerto Rico has long been largely a homework industry, organized through a complex system of contractors and subcontractors.⁸⁹ On its face, the language of the act is broad enough to include homework production. This is particularly true since the definition of "new industry" is keyed to the article produced rather than to the organization of the production. Whether the act will be deemed applicable only to industrial plants and shops, and not to subcontracting of homework remains for future administrative and perhaps judicial determination. It is to be noted, however, that the proviso following section 1 (c) employs the words "industrial establishment" at two places, and the words "industrial facilities" in a third. This provision defines the rights of previously operating enterprises, which, under the product enumeration, may qualify for the "new industry" exemption. Therefore, it is at least possible to infer that the legislature granted tax exemption only to factories or shops, and not to less centralized organizations like homework industries.

A final problem of statutory construction arises from the enumeration of exempt products. The exact scope of the words employed therein is to some extent a technical problem. For example, the products covered by such

See *People ex rel. Turner Construction Co. v. Cantor*, 196 App. Div. 213, 186 N. Y. Supp. 890 (1921), where the prosecuting company, engaged in constructing buildings through contractors, which did not maintain any shops to manufacture articles for use in its business except "one small woodworking mill," was held not to be engaged in manufacturing, hence not exempt. Cf. dicta in *People ex rel. Stokes v. Roberts*, 90 Hun. (N. Y.) 533, 36 N. Y. Supp. 73 (1895), indicating that where a substantial amount of the work involved is done by the contractee, in addition to that done by the contractor, the former may be entitled to tax exemption.

87. *State ex rel. N. American Phonograph Co. v. State Bd. of Assessors*, 54 N. J. L. 430, 24 Atl. 507 (1892), in which the decision turned on the view that the contracting parties were in the relation of principal and agent. In reference to the principal, then, says the court, the plant of the contracting manufacturer "is *pro hac vice* its plant, and it is thereby located and carries on business within this state."

A similar argument was expressly refuted, however, in *H. M. Rowe Co. v. Beck*, 149 Md. 251, 131 Atl. 509 (1925) and *People ex rel. Jewelers' Circular Publishing Co. v. Roberts*, 155 N. Y. 1, 49 N. E. 248 (1898).

88. Section 1 (c) (32). Although much needlework is done in the home (see Puerto Rico Dept. of Labor, *Annual Report*, 1941-42, p. 16), nevertheless some 263 factory type establishments engaged in needlework, employing 11,288 persons, were inspected by the Department of Labor in the fiscal year 1941-42 (*ibid.*, p. 42).

In the fiscal year 1939-40, Puerto Rico exported \$15,432,000 of needlework, second only to sugar and molasses in value of exports. Puerto Rico Dept. of Agric. and Commerce, *Puerto Rico, Industrial and Commercial*, 24 (1941). Detailed statistics on the needlework industry can be found in *ibid.*, p. 41. A full description of this industry is contained in De Golia, *Porto Rico: What It Produces and What It Buys*, U. S. Dept. of Commerce, TRADE INFO. BULL. 785, 26 *et seq.* (1932).

89. De Golia, *op. cit. supra* n. 88, p. 26 *et seq.*; DIFFIE, *op. cit.* n. 14, p. 179 *et seq.* In the summer of 1942, the Commissioner of Labor reported that, in the needlework industry, somewhat less than 4000 women were working in shops, and somewhat less than 40,000 in the home. Puerto Rico Dept. of Labor, *Annual Report*, 1941-42, p. 15-16.

words as "cosmetics," "tannery product," and "articles of straw, reed, and other fibers" are clearly more numerous than those encompassed by "matches," "candles," and "soaps." Intermediate between these groups may be found other enumerated items of varying degrees of specificity.

Under comparable statutes,⁹⁰ the courts have been faced with a substantial amount of litigation, as various enterprises have sought to bring themselves within the scope of one of the enumerated industries designated as tax-exempt. Hence, one finds cases holding that bags made from paper are not "articles of wood,"⁹¹ nor are bricks deemed "articles in a finished state";⁹² and a cotton ginnery is not engaged in the manufacture or processing of cotton.⁹³ Illuminating gas and seltzer water are not "chemicals";⁹⁴ feed for live stock is not "flour";⁹⁵ linotypes produced by linotype machines are not themselves "machinery";⁹⁶ making paper boxes is not the making of "paper";⁹⁷ manufacturing shoe uppers is not manufacturing of "shoes";⁹⁸ and, in like manner, the production of clothing⁹⁹ or umbrellas¹⁰⁰ is not within an exemption for manufacturers of "textile fabrics." On the other hand, a maker of sugaring equipment is exempt as a maker of "agricultural implements" (sugar being an agricultural product);¹⁰¹ an ice cream plant was held to be a "creamery,"¹⁰² and telephone poles¹⁰³ as well as barrels¹⁰⁴ are "articles of wood."

The determination of these problems is largely a matter of factual analysis, in which each case is *sui generis*. The solution, under the act, is

90. See GEORGIA CODE ANN. (1938) § 92-216, an enabling act passed pursuant to provisions of GA. CONST. ART. VII, § 2, par. 2-a [GA. CODE ANN. (1938) § 2-5003]; LOUISIANA CONST. of 1879, ART. 207, enumerating as exempt, manufacturers of textiles, leather, shoes, harness, saddlery, hats, flour, machinery, agricultural implements, ice, fertilizer, chemicals, furniture, soap, stationery, ink, paper, boats, and chocolate; MISSISSIPPI CODE ANN. (1942) § 9703, as amended, enumerating over 40 categories, ranging in products from coffins to automobiles and from golf clubs to tung oil, and in processes from canning to creosoting and from condensing milk to shelling pecans.

91. Pineland Bag. Corp. v. Riley, 142 Miss. 574, 107 So. 554 (1926).

92. Currie-Finch Brick Co. v. Miller, 123 Miss. 850, 86 So. 579 (1920), applying the *ejusdem generis* rule. For similar administrative opinion as to the scope of this phrase, see *Reports of the Attorney General of Mississippi*, 1907-09, pp. 44, 57, 343, 359, 380; *ibid.* 1911-13, pp. 50, 199, 330.

93. Georgia Warehouse Co. v. Jolley, 172 Ga. 172, 157 S. E. 276 (1931).

94. Shreveport Gas, Electric Light & Power Co. v. Assessor, 47 La. Ann. 65, 16 So. 650 (1895); Crescent City Seltz and Mineral Water Co. v. New Orleans, 48 La. Ann. 768, 19 So. 943 (1896).

95. Atlas Feed Products Co. v. New Orleans, 113 La. 611, 37 So. 531 (1904).

96. Nicholson v. Board of Assessors, 48 La. Ann. 1570, 21 So. 167 (1896).

97. Washburn v. New Orleans, 43 La. Ann. 226, 9 So. 37 (1891).

98. Ricks v. Board of Assessors, 43 La. Ann. 1075, 10 So. 202 (1891).

99. Cohn v. Parker, 41 La. Ann. 894, 6 So. 718 (1889).

100. Lake Bros. v. Guillotte, 48 La. Ann. 870, 19 So. 924 (1896).

101. State *ex rel.* Fredericks v. Board of Assessors, 41 La. Ann. 534, 6 So. 337 (1889); Taylor Bros. Iron Works Co. v. New Orleans, 44 La. Ann. 554, 10 So. 3 (1892).

102. Miller v. Pitts, 179 Ga. 789, 177 S. E. 587 (1935).

103. Shreveport Creosoting Co. v. Shreveport, 119 La. 637, 44 So. 325 (1907).

104. New Orleans v. Le Blanc, 34 La. Ann. 596 (1882).

left to the procedures of the administrative organization herein previously described. This may avoid considerable litigation.

COMPARISON TO OTHER TAX EXEMPTION LAWS

Industrial tax exemptions in the United States are by no means a recent development but date back to Colonial days.¹⁰⁵ In 1789, the New Hampshire legislature enacted a statute exempting Eliphalet Hale's paper mill at Exeter from taxation,¹⁰⁶ while in 1808, and again in 1816, more generalized industrial exemption laws were passed in the same state.¹⁰⁷ Between the years 1805 and 1820, in New Hampshire alone, some sixty statutes granting industrial exemptions to specific individuals and corporations (generally as part of the charter of incorporation) became law.¹⁰⁸

Historically, the greatest impetus to such legislation has come in post-war periods,¹⁰⁹ and in times of depression.¹¹⁰ Geographically, tax exemption has long been a weapon in the intersectional industrial rivalry between the Northeast and the South.¹¹¹

Industrial tax exemptions vary greatly in degree and duration, in the nature of the exempt classifications, and in the requirements for qualification. A number of these laws have been limited in application to only one or two highly favored industries. Thus Alabama has a special ten year exemption for calcium cyanamide (fertilizer) and aluminum plants;¹¹² California exempts various orchard trees and vineyards;¹¹³ Florida and Delaware exempt motion picture studios;¹¹⁴ Iowa once favored the sugar beet in

105. See WARE, *THE EARLY NEW ENGLAND COTTON MANUFACTURE*, 20 (1931); BIDWELL, *TAXATION IN NEW YORK STATE* 194 (1918); Report of the Massachusetts Commissioner of Taxation, *Taxation and Exemption Therefrom*, 159 (1875); Stimson, *The Stimulation of Industry Through Tax Exemption*, 11 *THE TAX MAGAZINE*, 169 (1933).

106. 5 New Hampshire Laws 428 (1789).

107. 7 New Hampshire Laws 770 (1808); 8 New Hampshire Laws 496 (1816).

108. So stated in *Eyers Woolen Co. v. Gilsum*, 84 N. H. 1; 19, 146 Atl. 511 (1929).

109. *War of 1812*: Maine, Laws 1820-21, ch. 85; Maine, Public Acts 1825, ch. 288. *Civil War*: LOUISIANA CONST. 1879, Art. 207; Maine, Acts and Resolves 1864, ch. 234. *World War I*: South Carolina, Acts 1924, p. 977, 1080; Arkansas, Acts 1927, p. 1209. See Stimson, *The Exemption of Property From Taxation in the United States*, 18 *MINN. L. REV.* 413, 417 (1934).

110. Alabama, Laws Ex. Sess. 1936-37, p. 95-98; Delaware, Laws 1937, ch. 44. See Putney, *Exemptions From Taxation*, EDITORIAL RESEARCH REPORTS, vol. 1-1941, p. 23, 36 and Killough, *Tax Exempt Industries in Rhode Island*, 26 *BULL. OF NATL. TAX ASSN.*, 34, 48 ff. (1940).

111. Thus, out of 19 states granting some form of industrial tax exemption in 1934, 10 were in the South (Alabama, Arkansas, Georgia, Louisiana, Maryland, Mississippi, Oklahoma, South Carolina, Tennessee, and Virginia) and 7 were from the Northeast (Delaware, Massachusetts, New Hampshire, New Jersey, Pennsylvania, Rhode Island, and Vermont). Stimson, *op. cit. supra* n. 109.

112. CODE OF ALABAMA (1940), Title 51, § 10.

113. CALIF. CONST. OF 1879, Art. XIII, § 12-3/4 (adopted 1926).

114. FLORIDA CONST. OF 1885, Art. 9, § 14 (added in 1934); Delaware Laws 1937, ch. 44.

dustry,¹¹⁵ as did Wyoming;¹¹⁶ Wisconsin grants a three year exemption to zinc oxide producers;¹¹⁷ Michigan once exempted salt manufacturing;¹¹⁸ Oklahoma's only industrial exemption has been for cotton textile manufacturing,¹¹⁹ the same being true of Arkansas;¹²⁰ and New York formerly assisted corporations engaged in foreign ocean commerce.¹²¹ Canada has had a similar experience; British Columbia exempted coal mines and coke ovens,¹²² while Manitoba favored creameries and cheese factories.¹²³ Since 1922, the Federal Government has granted special tax exemptions to corporations engaged in the China Trade.¹²⁴

In other jurisdictions, the industries designated to receive tax exemption are more numerous. The classes enumerated may number only a few, as in New Mexico, where beet sugar factories, broom factories, woolen mills, smelters, cement and plaster plants, water power plants, and refining and reductions works were singled out.^{124a} Or the list may cover nearly every conceivable type of manufacturing, as is the case in Mississippi,¹²⁵ and to a lesser degree, in Louisiana.¹²⁶ Intermediate between these extremes, are the moderately extensive enumerations found in the Alabama,¹²⁷ Georgia,¹²⁸ South Carolina,¹²⁹ and Florida¹³⁰ exemption laws. With the exception of the Mississippi statute,

115. IOWA CODE ANN. 1913, § 1304a, Supplement (1913), p. 446 and Supplemental Supplement p. 107-8 (1915).

116. WYOMING COMPILED STATS. ANNO. 1910, § 2321 (Fifth).

117. WISCONSIN STATS. 1945, § 70.11 (17).

118. Act of Feb. 15, 1859, quoted in *East Saginaw Salt Mfg. Co. v. East Saginaw*, 19 Mich. 259, 2 Am. Rep. 82 (1869).

119. Okla. Session Laws 1915, ch. 195, § 1, enacted pursuant to OKLA. CONST. 1907, Art. x, § 6.

120. ARK. CONST. OF 1874, Amendment 12, adopted 1926.

121. Baldwin's Consol. Laws of N. Y. (1938), Tax Law, Art. I, § 4 (11).

122. BRITISH COLUMBIA, REV. STATS. (1911), Vol. III, ch. 222, § 8 (33).

123. MANITOBA, REV. STATS. (1913) Vol. II, ch. 134, § 4.

124. CHINESE TRADE ACT OF 1922, 42 STAT. 849, 15 U. S. CODE, chap. 4. (1922).

124a. NEW MEXICO STATS. ANN. § 5429 (1915).

125. MISSISSIPPI CODE ANN. § 9703 (1942) (as amended), described *supra* n. 90.

126. LA. CONST. OF 1879, Art. 207, described *supra* n. 90.

127. CODE OF ALABAMA (1940), Title 51, § 3, listing thread, textiles, clothing, aircraft, shipbuilding, bags, wood pulp products, glass, ceramics, enamelware, farm implements, and dairy products industries.

128. GEORGIA CODE ANN. (1938) § 92-216, listing plants for "the manufacture of processing of cotton, wool, linen, silk, rubber, clay, wood, metal, metallic or nonmetallic minerals, or combinations of the same, cream or cheese plant, or for the production or development of electricity. . ."

129. SOUTH CAROLINA, CONST. OF 1895, ART. 8, § 8, par. 2 listing "furniture factories, pulp and paper mills, and cigarette and tobacco factories of value above one hundred thousand (\$100,000.00) dollars . . ." in two named counties, as being exempt. Also, South Carolina Code of Laws (1932) § 2597, enumerating as entitled to exemption, "all cotton, yarn, hosiery, bleaching, woolen, rubber, pulp, paper, veneer, furniture, pottery and chemical manufacturing establishments . . ." in the county of Georgetown, of the value of \$100,000 or more. Industrial tax exemption in South Carolina has been characterized by a hodge-podge of individual exemption statutes applicable only in named counties, with a considerable variation in the type of plant and valuation requirements for exemption.

130. FLORIDA CONST. OF 1885, Art. 9, § 12 (added 1930) listing shipbuilding, tires, textiles, wood pulp, paper, bags, fiber board, automobiles, aircraft, glass and crockery industries, and the refining of sugar and oils.

Act No. 346 of Puerto Rico is the most sweeping statute of this type found on record.

The Puerto Rican act is not solely an "enumeration type" of statute. It grants a blanket exemption to all industries producing articles of commerce not previously produced on the island.¹³¹ In this respect, Act No. 346 is comparable to the numerous tax exemption statutes which, making no enumeration, state their applicability in general to newly located "manufacturing establishments,"¹³² or "to all persons, firms and corporations engaged in the branches of manufacturing industry,"¹³³ or simply to "manufacturing property."¹³⁴

Because it applies in terms to *all* truly new industries, as well as to many already established on the island, the scope of Act No. 346 exceeds that of any other industrial exemption statute found. The most significant impact of the statute, however, lies in the fact that enterprises qualifying will be exempt not only from all insular taxes, but also from all *federal* taxation.¹³⁵ Thus, industrial concerns may obtain benefits not available under any *state* tax exemption laws.¹³⁶

EFFECTIVENESS OF TAX EXEMPTIONS TO ATTRACT INDUSTRY

There has been considerable controversy as to the effectiveness of tax exemption laws in accomplishing their chief purpose: to influence the location of industry. One authority on the subject has stated that:¹³⁷

131. Section 1.

132. KENTUCKY CONST. § 170; KENTUCKY REV. STATS. § 91.260 (1946); New Hampshire, Public Stats. and Session Laws, Supp. 1901-13, p. 94; New Hampshire, Public Laws (Special Sess. 1927) ch. 136; Vermont Public Laws § 594 (1933).

133. Maryland, Laws of 1916, ch. 561; see also, ANNO. CODE OF MARYLAND (1939), Art. 81 § 7(23), authorizing local exemption of machinery used in "manufacturing."

134. RHODE ISLAND, GEN. LAWS 1938, ch. 29, § 4.

135. ORGANIC ACT, 31 STAT. 78 (1900), 48 U. S. C. § 740; 39 STAT. 954 (1917), 48 U. S. C. § 734; INT. REV. CODE § 3360(c).

136. Notice should be taken of the fact that even in states which do not have statutory tax exemption privileges, such exemptions, either in whole or in part, are frequently granted by local government, either illegally, or by means of a subterfuge. See Lowry, *Municipal Subsidies to Industries in Tennessee*, 7 So. ECON. J. No. 3 (1941), reprinted in South Carolina Planning Board, Pamphlet No. 9, *Is New Industry Tax Exemption Effective?* 26 (1943); Tax Policy League, *Tax Exemptions*, (symposium) 46 (1939); Putney, *Exemptions from Taxation*, Editorial Research Reports, vol. 1-1941, p. 23, 36; Conn. Commission on Tax Exemptions, *Report*, 44 (1925).

Some common practices along these lines are:

(1) under-assessment of industrial property: see survey by S. C. Planning Bd., *op. cit.*, pp. 15 (Georgia) and 17 (Pennsylvania); Natl. Ind. Conf. Bd., *State and Local Taxation of Business Corporations*, 97 (1931); Corbin, *Taxation of Mercantile and Manufacturing Corporations*, PROCEEDINGS OF NATL. TAX ASSN. 309 *et seq.* (1909).

(2) offering of free factory sites: This practice has apparently been significant in Michigan (S. C. Planning Bd., *op. cit.*, p. 17) and California (*ibid.* p. 16).

(3) Leasing of publicly owned factory buildings to private industry at nominal rentals: see 54 American City 95 (April 1939), describing such practices in Hazelton, Pa. and Natchez, Miss. In the latter case, the rental for a tire factory built and leased by the city was \$50 per month.

137. Stimson, *The Exemption of Property from Taxation in the United States*, 18 MINN. L. REV. 413, 424 (1934), *Accord*, Martin, *The Social Aspects of Tax Exemption*,

"There is no evidence that this purpose is accomplished. A comparison of industrial growth, measured by the increase in value of manufactured products and in income reported by industrial corporations, in states granting such exemptions and in similarly situated states not granting them indicates that exemptions have not modified industrial development. It is fairly certain that other factors, such as location of raw materials and markets, character of the labor supply, availability of capital, and transportation facilities, are much more fundamental than tax exemption in determining the location of industrial enterprises."

It has been pointed out¹³⁸ that a generalized statement of this sort is of scant validity because of the scarcity of comparable data from the various states. In the only thorough comparative statistical study of the problem yet made,¹³⁹ the conclusion was that:

"There is no question but that industries might move from one state to another if the tax differential were sufficiently large. This would be particularly true of marginal firms located in unfavorable sections. But in the nine states selected for this study the tax differentials were not large enough to force industrial relocation,"

The South Carolina State Planning Board published a few years ago a report of a survey made in that state. On the basis of questionnaires sent to county treasurers, it was "the considered and collective opinion of the majority of the counties that tax exemptions do not have a controlling influence in locating industry."¹⁴⁰ In a survey of new industries locating in South Carolina since 1940, the Board found that location of raw materials, availability of local markets, adequacy of labor supply, and presence of good transportation were deemed more important considerations than exemption from taxation.¹⁴¹ Such exemptions were welcomed in every case, but, says the Board, "In no case known to us was any industry on this list of new plants located primarily because of local tax exemption."

In a similar survey by questionnaires sent to eighteen different state

183 ANNALS OF THE AMER. ACAD. OF POL. & SOC. SCIENCE 48, 52 (1936), citing on this point, *Report of the Special Committee on Taxation and Debt in Florida*, 82 (1935) and LUTZ, *THE GEORGIA SYSTEM OF REVENUE* 41.

138. Corder, *State Tax Burdens as an Influence on the Location of Industry*, 19 TAXES 537, 538 *et seq.* (1941).

139. Steiner, *The Tax System and Industrial Development*, 35 UNIV. OF ILL. BULL. No. 58, 46 (1938). The states covered by this analysis were Illinois, Indiana, Massachusetts, Michigan, Minnesota, New York, Ohio, Pennsylvania, and Wisconsin, none of which have a general industrial tax exemption statute.

140. South Carolina Planning Board, Pamphlet No. 9, *Is New Industry Tax Exemption Effective?*, 8 (1943). The significance of this conclusion is minimized by the fact, that as between counties, there is no substantial differential in tax savings since all but three of the 46 counties in the state grant a five-year exemption to new industry. See editorial in *The Columbia Record*, Aug. 3, 1942, and S. C. Planning Bd., Pamphlet No. 6, *The Woolen and Worsted Industry in South Carolina* (1942).

141. S. C. Planning Bd., Pamphlet No. 9, *Is New Industry Tax Exemption Effective?* 13 (1943). Similar conclusions were reached in STOKES, *CARPETBAGGERS OF INDUSTRY* (1935), quoted in S. C. Planning Bd., *op. cit.* p. 24, and in Metrop. Life Ins. Co. Policyholders Service Bu. and Natl. Elec. Light Assn. Civic Dev. Com., *Industrial Development in the United States and Canada, 1926 and 1927* (no date), quoted in *ibid.*, p. 23. See also, in *accord*, HOLMES, *PLANT LOCATION* (1930).

taxing authorities, the Board found only one state, Louisiana, which felt that tax exemption had been a successful inducement to industrial location.¹⁴² Alabama, Mississippi, Arkansas, and Oklahoma thought other factors were more important, while the answers given by Tennessee, Connecticut, and Virginia impliedly admitted the effectiveness of tax exemption, but were opposed to it on other grounds.¹⁴³ The remaining ten states either had no experience with industrial tax exemption or expressed no opinion as to its effectiveness.¹⁴⁴

Surveys of a generalized nature, such as the foregoing, must of necessity be inconclusive. Immunity from taxation is but one of many factors involved in attempts to cut costs of production, including the major items of interest, labor, materials, power and transportation.¹⁴⁵ The influence of the various factors will vary from one industry to another as well as from firm to firm.¹⁴⁶ The effectiveness of tax exemption thus depends upon whether the element of taxes bulks relatively large in the analysis of alternative cost structures in contemplated localities. Unless the possible savings through tax exemption appear to be quite substantial, certain intangible factors, such as the attitude of government toward business, climate, recreational facilities, or considerations of intracorporate coordination and concentration, will often prevail.¹⁴⁷

142. "It is an inescapable fact that during the existence of the tax exemption law, Louisiana experienced the greatest industrial expansion in its history." Quoted from Report of the Bd. of Dir. of the Dept. of Commerce and Industry of La., May 1, 1942, in S. C. Planning Bd., *op. cit. supra* n. 141, p. 16. See also, Mass. Commission on Interstate Cooperation, *Final Report Concerning Migration of Industrial Establishments From Massachusetts*, (1939) reprinted in *ibid.*, p. 30 *et seq.* This Massachusetts body felt that although tax differentials were not "an important factor" in the widespread industrial migration from the state, they did have "some bearing." And it was recognized that establishments getting tax exemptions in the South "have a distinct advantage" over those in Massachusetts and elsewhere not getting exemptions.

143. Tennessee: "From the standpoint of inducement, tax exemption does not work. It serves as an inducement only for the period for which the exemption applies and experience shows that many of these plants leave the community as soon as the exemption period expires." *op. cit.* p. 15.

Connecticut: "We have learned through sad experience that the concerns which are attracted to a state or community through special inducements are not particularly desirable." *op. cit.* p. 17.

Virginia: "The cities experienced in tax exemption are not convinced that the practice is beneficial in the long run." *op. cit.* p. 14.

144. These states were: Maryland, North Carolina, Kentucky, Georgia, Florida, California, Massachusetts, Michigan, Missouri, and Pennsylvania.

145. Stimson, *The Stimulation of Industry Through Tax Exemption*, 11 THE TAX MAGAZINE 221, 225 (1933): "The immunity from taxation, to be effective, must be of sufficient value to the manufacturer to offset any disadvantages that might exist in the way of distance to raw materials, labor supply, and selling market."

146. See Cordner, *op. cit. supra* n. 138, p. 604 *et seq.*, and Martin, *Effects of Taxation on Industrial Development With Special Reference to the South*, reprinted from 20 SOUTHWESTERN SOCIAL SCIENCE QUARTERLY (1940) in S. C. Planning Bd., *op. cit. supra* n. 141, p. 3.

147. Killough, *Tax Exempt Industries in Rhode Island*, 26 BULL. OF NATL. TAX ASS'N. 34, 44 (1940). See S. C. Planning Bd., *op. cit. supra* n. 141, p. 23, listing eleven factors more important than tax advantages as a reason for location of plants: Markets, Labor, Transportation, Materials, Availability of factory buildings, Personal reasons, Power and fuel, Cheap rent, Nearness to related industries, Living conditions, and Financial aid.

In evaluating Act No. 346 the previously discussed experience of the states, (most of which were Southern) is of little weight. In the first place, property taxes (which constitute the main source of revenue for state, county, and municipal government)¹⁴⁸ are usually rather low in the South.¹⁴⁹ Savings through tax exemption would therefore generally not be large. Secondly, "although the *amount* of tax load is a material, even though comparatively minor cost factor, the difference in the amount as between one state and another is rarely as important as variations in other expenses—notably labor, power, transportation, marketing, and rental costs."¹⁵⁰

Neither of these considerations apply to the Puerto Rican exemption law. Under it, qualified industries are exempt from *both* insular and federal taxation. The extent of these savings will vary considerably from industry to industry,¹⁵¹ and from firm to firm, and must be balanced as against other possibly disadvantageous cost factors. But it is to be expected that this unique twofold immunity will create much more substantial savings than is possible in the states. Attention should also be directed toward abundance of comparatively low-wage labor in Puerto Rico,¹⁵² a factor which, together with

148. Natl. Ind. Conf. Bd., Research Report No. 64, *Tax Burdens and Exemptions*, 59 (1923); Woodworth, *Importance of Property Tax in State and Local Tax Systems*, in TAX POLICY LEAGUE, *Property taxes* (symposium), ch. 1 (1940); Comment, *Judicial Restoration of the General Property Tax Base*, 44 YALE L. J. 1075 (1935).

149. Roesken, *Tax Trends in the Southern States*, 24 TAXES 323, 326 (1946).

150. Martin, *op. cit. supra* n. 146, pp. 3-4; see also, Steiner, *op. cit. supra* n. 139, p. 46.

151. From 1931-1939, federal corporate income taxes averaged 21.9% of income less deficit before taxes of manufacturing corporations. Among product classifications, the percentage ranged from a high of 91.6% for textile manufacturing to a low of 13.9% for tobacco manufacturing. Natl. Ind. Conf. Bd., *Effects of Taxes Upon Corporate Policy*, 24 (1943).

152. See note 15 *supra*. In July, 1945, approximately 11% of the labor force of Puerto Rico was unemployed (i.e. 72,300 unemployed out of a total labor force of 675,000). DESCARTES, BASIC STATISTICS ON PUERTO RICO 61 (1946).

Average wage rates of industrial workers in Puerto Rico, as found in Annual Reports of the Puerto Rican Dept. of Labor, for the following years were:

1936-37	13.4¢ per hour	1939-40	20.9¢ per hour
1937-38	15.7 per hour	1940-41	22.6 per hour
1938-39	19.3 per hour	1941-42	25.1 per hour
		1942-43	28.0 per hour

The passage of the Fair Labor Standards Act of 1938, 52 STAT. 1062 (1938), caused great consternation in Puerto Rico, particularly in the needlework, sugar, and tobacco industries, where the prevailing wage scale was far below the statutory minimum. See Puerto Rico Dept. of Labor, *Annual Report 1938-39*, p. 33. Many employers in the needlework industry threatened to move their businesses to China and the Philippines, "where conditions, as they claimed, were better for them to do business on account of the meager wages paid to the workers." (*ibid.* 1940-41, p. 11).

But on June 26, 1940, the President approved an amendment to the F. L. S. A. empowering the Wage and Hour Administrator to appoint special committees to adjust wage rates in Puerto Rico (54 STAT. 615 f 1940). A Committee was duly appointed on August 1, 1940, which proceeded to hold hearings, and on the basis thereof, minimum wage rates were recommended and approved by the Administrator, ranging from 12.5 cents per hour to 25 cents per hour. (*ibid.* 1940-41, p. 10). Thus the wage differential existing between the mainland and the Island was perpetuated under the Fair Labor Standards

the broad tax exemption, may well stimulate a large influx of industry to the island.¹⁵³

There can be little doubt that tax exemption advantages have been primarily *responsible* for the choice of location of many individual plants in the past.¹⁵⁴

Thus, in some places, and to some extent at least, it would seem that the purpose behind tax exemption laws has been realized.

ULTIMATE EFFECT ON THE ECONOMY

One must remember, however, that there is a secondary purpose to such exemption as this. It is contemplated that, after the relatively short period of tax exemption has expired, the industries attracted thereby will be well established. The termination of the exemption is expected to broaden the tax base by the amount of the previous exemption. Thereby, it is hoped to make

Act. The presently prevailing statutory minimum wages in various industries in Puerto Rico are listed in Office of Information for Puerto Rico, *Puerto Rico Handbook*, 32 (1947).

153. In Tennessee, where a comparable combination of local tax exemption policies and abundant low-wage labor existed in the recent great depression, it was found in 1937 that, out of 35 new industries established since 1930 in towns of less than 10,000 population, 31 were being subsidized by tax exemption or its equivalent. "A large proportion of factories in the smaller towns were brought in since January, 1930, indicating a remarkable acceleration of small-town industrialization . . . Low-wage garment and shoe manufacturers of outside origin accounted for most of the increase in the number of factory units established since January, 1930, and nearly all were subsidized. The data do not indicate, however, whether the garment and shoe industries were being attracted by the special inducements or were merely accepting them as incidental to larger consideration of plant location—such as labor supply or relative wage levels." Lowry, *op. cit. supra* n. 136, p. 28-29.

The significance of the dual nature of the Puerto Rican tax exemption is increased when reference is made to the tremendous development in federal tax revenues in recent years. From 1939 to 1944, for example, federal internal revenues rose from 5.2 billions to 40.8 billions, while state and local tax revenues rose only from 7.9 billions to 9.7 billions. Blakely, *Post War Tax Problems*, 17 *STATE GOVERNMENT* 422 (1944). While this growth was admittedly abnormal, due to the war emergency, recent developments at home and abroad lend additional authenticity to the statement of Mr. Blakely, President of the National Tax Assn., that "The prospect is that individuals and businesses will have very high taxes as far ahead as we can see." (*ibid.* p. 422).

154. See sources cited *supra* n. 142-143; Conn. Commission on Tax Exemptions, *Report*, 34 *et. seq.* (1925); Stimson, *op. cit. supra* n. 145, p. 223, reporting that as late as 1930, there was over one million dollars worth of exempt industrial property in Connecticut, despite the known illegality of such exemptions; New Hampshire State Tax Commission, *Report*, 7 f. (1913), and *ibid.* 13 f. (1914).

Killough, *Tax Exempt Industries in Rhode Island*, 26 *BULL. OF NATL. TAX ASS'N.* 34 (1940), gives several examples of plants locating as the result of tax exemption inducements. Apparently, the author finds the inducement was greatest for plants making shoelaces, buttons, ribbons and similar small items. As for the woolen textile industry, the author states, at p. 45, "Apparently more than 90 per cent of the factories employing more than 90 per cent of the workers in the woolen and worsted industry in Rhode Island had located there without the inducement of tax exemption. It was probably true, nevertheless, that tax exemption was responsible for the location of some woolen and worsted factories in particular towns and cities."

For cases where it was alleged that the tax exemption was the reason for the location of the plant, see *Crafts v. Ray*, 22 R. I. 179, 46 Atl. 1043 (1900), and *East Saginaw Salt Mfg. Co. v. East Saginaw*, 19 Mich. 259, 2 Am. Rep. 82 (1869).

a general reduction in tax rates as the previously exempt industries begin to share in paying for the cost of government.¹⁵⁵

In justification of tax exemption policies, it is usually argued that lax administration of property taxes in many localities has removed the principle of equality from public consciousness, thus tending to make tax exemptions the usual and accepted practice.¹⁵⁶ This argument is one of political expediency; and it finds additional support in the argument that no appropriations are necessary, as would be the case if a direct subsidy were employed. The policy will be expedient politically to the extent that it gets results that the electorate wants without excessive costs or corresponding disadvantages that the electorate does not want.

One authority says that "No form of tax concession has received such universal condemnation from tax experts as the exemption of industrial properties from taxation."¹⁵⁷ First, tax exemption is said to be a form of economic warfare between states (and, one may add, between nations¹⁵⁸) which weakens the economic structure of the participants.¹⁵⁹ Its adoption by one state tends to encourage similar action by neighboring states hence eliminating the advantages received by any community without eliminating the disadvantage undergone by it.¹⁶⁰

Second, it is argued that tax exemption tends to encourage industry on the shaky basis of lower tax costs, rather than on the firm footing of permanent economic savings.¹⁶¹ This is often true where no investigation is made beforehand of possible benefits and burdens,¹⁶² and where exemptions are liberally extended to all applicants regardless of the permanence or stability

155. See *Crafts v. Ray*, *supra* n. 154, and quotation therefrom, *supra* p. 12-13 and the quotation from *Colton v. Montpelier*, 71 Vt. 413 (1899), *supra* p. 27.

156. Lowry, *op. cit. supra* n. 136, p. 27.

157. Putney, *op. cit. supra* n. 136, p. 36. See also, Adams, *Taxation in Maryland*, in *JOHNS HOPKINS STUDIES IN STATE TAXATION*, 70 (1900), where industrial tax exemption is characterized as a "palpable mistake."

158. Mexico has a five year new industry exemption: Presidential Decree approved Dec. 30, 1939, 118 *Diario Oficial de Mexico* No. 40 (1940), described in 74 *Bull. of Pan Amer. Union* 661 (1940). See also, 74 *id.* 788, describing an import tax exemption by Ecuador for certain industrial imports, in order to stimulate home production.

159. Kenneth J. McCarren, vice-president of the Detroit Board of Assessors, in *TAX POLICY LEAGUE, Tax Exemptions* (symposium), ch. III (1939).

160. See the statement by McCarren, *loc. cit. supra* n. 159: "The most serious aspect of these subsidies rests in the fact that there is no logical end. The granting of subsidies by one community eventually impels other communities to grant similar or larger subsidies, almost as measures of self-protection. Such a policy, if continued over a long enough period of time, should logically end in complete exemption of all industrial enterprises, with disastrous effects on our whole national economy." *Accord*, Miller, *Attracting Industry Through Tax Exemption*, 10 *MUNICIPAL FINANCE*, No. 3, 23 (Feb. 1938).

161. McCarren, *op. cit. supra* n. 159.

162. The Virginia exemption law, *TAX CODE* 1930, p. 2255, is unique in that it requires the local governing body to find, pre-requisite to granting of an exemption, that the loss in revenue will be more than compensated by the establishment of the new industry.

of the enterprise. Tax exemption laws have sometimes encouraged "fly-by-night" industries which:

"would gain all the benefits of an organized community without adequate payment for municipal service rendered, and would commercialize a gesture on the part of a misguided legislature, which contemplated building up a community of permanence and stability, with the prospect of the eventual payment of taxes after the period of exemption had expired.¹⁶³

Even where the plant is established locally in good faith, but upon the economically unsound basis of temporary tax savings, it may find it necessary to shut down or move elsewhere after the period of exemption has expired. If they do not leave, opponents of tax exemption legislation claim that:

"there is no way they can possibly avoid payment of the taxes for the period for which they were supposedly exempt. The reason for this is that the expense incurred in providing community services for the firm have been reflected in the city's debt structure or assessed valuation to the point where the industry will have to pay anyway."¹⁶⁴

This logic would apply to a one-industry town but probably has little relevancy to the discussion of the Puerto Rican statute. Taxable property and income in Puerto Rico is already substantial and the incidence of any increase would be widespread.

Furthermore, this result will not be detrimental to "infant industries" which, although founded on a sound economic basis, require assistance in their initial years of operation. But it has been pointed out that some industries never outgrow their stage of "infancy";¹⁶⁵ and that it is an extremely difficult task to determine beforehand which industries will be able to mature sufficiently to weather the storms of competition after the exemption period has expired.¹⁶⁶

Third, even though the beneficiary industry does not move elsewhere at the end of the exemption period, the cost to the community can still be a high one.¹⁶⁷ A careful investigator in Rhode Island found that:

"When tax exemption brings new concerns, new buildings and new workers into a growing community it is directly responsible for a growth in community

163. Miller, *op. cit. supra* n. 160, p. 25.

164. South Carolina Planning Bd., *op. cit. supra* n. 141, p. 15.

165. Conn. Commission on Tax Exemption, *Report*, 34-47 (1925); Stimson, *The Stimulation of Industry Through Tax Exemption*, 11 THE TAX MAGAZINE 221, 222 (1933).

166. Stimson, *op. cit. supra* n. 165, p. 222.

167. A most graphic illustration is offered by Stimson, *Exemption From Property Tax in California*, 21 CALIF. L. REV. 193 (1933) where, at p. 204, n. 47, the following passage is quoted from the San Francisco *Altá* of Oct. 5, 1869: "The mines were exempted from taxation when they were in the most luxuriant condition, and when a burden that is now oppressive would scarcely have been felt. Thus it is that counties with poor buildings, few good public wagon roads, no railroads, and in fact, with no property worthy of notice, are overwhelmed with debt."

costs. It is highly probable that the costs of the local government will increase more rapidly than the population. Even if the new concerns prosper and, at the end of the exemption period, begin to pay taxes it may be a long time before they compensate the community for the expenses they have caused."¹⁶⁸

During the period of exemption, these increased costs of governmental services must be met to a large extent by established industry, a result which is sometimes considered unfair especially where the subsidized industry is directly or indirectly competitive.¹⁶⁹ The Connecticut experience was that, "while such concerns may temporarily add to a community's payroll, they often contribute to the community's relief-load—especially in poor times."¹⁷⁰ Again it may be questioned whether these effects that are experienced when tax exemption attracts new industries and new workers to a town will appear where, as in Puerto Rico, the potential labor force is already resident within the taxing jurisdictions.

And, lastly, the experience in Tennessee cities has shown that after factories have been obtained, and the community economy has been shaped to them,

"it appears inescapable that factories or their equivalent in terms of employment and pay roll must be retained to avoid serious social and economic consequences. In order to hold the low-wage factories against labor costs that have been rising since the factories were brought in, the communities may find that subsidies must be continued or even increased."¹⁷¹

Taxation authorities who oppose such laws seem to agree that "equitable laws, fair play in taxation, and the elimination of restrictions affecting industrial plants will bring to any state its full quota of industries without the subsidy of tax exemption."¹⁷² Yet the failure of other methods of inducing industry to locate in Puerto Rico¹⁷³ has led to the present board experiment in tax exemption. The success of this legislation bids fair to be in keeping with the unprecedented scope of the exemption granted. Immunity from all federal as well as insular taxes, combined with the plentiful lower-wage labor of Puerto Rico, would seem to constitute a most compelling inducement for the establishing of industry there.

168. Killough, *Tax Exempt Industries in Rhode Island*, 26 BULL. OF NATL. TAX ASSN. 34, 50 (1940).

169. McCarren, *op. cit. supra* n. 159; Killough, *op. cit. supra* n. 168, p. 49; Tax Policy League, *Tax Exemptions* (symposium) 19 (1939).

170. S. C. Planning Bd., *op. cit. supra* n. 141, p. 17. In substantial agreement, see Rhode Island experience in Killough, *op. cit. supra* n. 168, p. 48 *et seq.*

171. Lowry, *op. cit. supra* n. 136, p. 29. Evidence in support of this statement may be found in the statistics compiled by Mr. Lowry, *ibid.* p. 28, which indicate that out of 31 factories in the smaller cities of Tennessee (under 10,000 population), 17 were still receiving tax exemption privileges after more than seven years of operation, despite the fact that five years is the regular exemption period.

172. Miller, *op. cit.* n. 160, p. 23.

173. See remarks of Puerto Rican Commissioner of Labor, quoted *supra* n. 15, and sources cited *supra* n. 18-19. *But cf.* Brief of the Government of Puerto Rico, presented to the Committee for Reciprocity Information, Wash., D. C. 57-63 (1947).

With direct subsidies legally impossible, little can be done by mainland communities to match the Puerto Rican exemption; it includes immunity from all federal taxation, a benefit not within the power of the states to grant. Of course, to the extent that industry does migrate from the states to this new area of tax immunity, federal revenues will also be diminished. As these effects are more sharply discerned, the combined pressure of adversely affected groups may well be expressed as a demand for federal legislation to remove the industrial tax differential now existing in Puerto Rico's favor. The strength of this demand will depend upon the extent to which the development of industry in Puerto Rico which the act brings to pass is achieved at the expense of mainland areas.

Regardless of whether such controversies materialize, the Puerto Rico experiment will certainly provide measurable criteria that have never existed before for evaluating the wisdom of a policy of industrial tax exemption.

Puerto Rico Dept. of Agric. and Commerce, *Puerto Rico Industrial and Commercial* (1941) is a good example of a well illustrated and written informational bulletin designed to inform potential entrepreneurs of insular advantages. On p. 2 is an imposing statement entitled, "Nineteen Good Reasons for Establishing Factories or New Industries in Puerto Rico."