TAXATION

by

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Author of A B C of Taxation

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EDITOR'S PREFACE

M. R. FILLEBROWN brings to the writing of this book a practical experience as a business man, and a theoretical knowledge as an earnest student of tax problems. The combination of the two qualities has given a simple and understandable book on a subject near to every citizen, since he pays taxes in some relation to society. As supplementary to this book it is proposed to add to the series a book on public finance, the two forming a fairly complete discussion of government finance.

F. L. M.

AUTHOR'S PREFACE

I DESIRE to make grateful acknowledgments to Harold L. Perrin, Ph. D., for indispensable help in fashioning this book, and to Professor F. Spencer Baldwin, of Boston University, who has read and revised both manuscript and proof.

C. B. F.

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CHAPTER I
NATURE OF TAXATION

AT no time have the problems of taxation been so prominently before the American public as at present. The cost of government is increasing, in consequence of the expansion of state activities and the growth of public extravagance. The existing methods of taxation do not respond satisfactorily to the new demands and reforms are urgently required. The general property tax, so long the keystone of the fiscal structure, has weakened under its own weight, and no longer serves its purpose. How shall the modifications in our tax system, made necessary by the new demands, be made? Shall they take the form of reinforcement of the old, or shall they abandon boldly their former methods, and build anew? It is with *1 these and similar problems that this little book attempts to deal.

1. Definition of a Tax

A tax is a compulsory contribution of persons toward the needs of government. It follows from this definition (a) that a tax involves coercion upon its bearers, (b) who are in every case either natural or legal persons, (c) and a specific public purpose as its end. Taxation includes the processes of levying, collecting, and paying taxes.

(a) The history of taxes reveals that their coercive nature is of comparatively recent development. The original idea of a tax was that of gift. Payment was not obligatory upon the subject, but consisted rather in a voluntary contribution toward the expenses of government, as appears from the medieval Latin term *donum*, and the English "benevolence." This conception of the relation between the subject and government was gradually transformed, payment becoming more and more obligatory, until finally coercive taxation resulted. At the present time payment of taxes is obligatory in all civilized nations; where the rate or imposition is at all dependent upon the taxpayer, the tax takes the form of a fee or payment for contractual services.

(b) The bearer of the tax is in all cases a person. Property belongs to some one, and when it is taken by means of taxation, the owner bears the burden. There can be no vital relation of obligation between inanimate property and the living state. The duty of supporting the state rests upon those who receive protection from it. While a large measure of the protection which the subject receives from the sovereign takes the form of

security of possession, the thing possessed is but an incident in the relationship of the state and the individual.

(c) The third element in the definition of a tax is a specific public purpose as its object. Taxes are levied for the benefit of government as a whole, not for the advantage of individuals or of a particular class. Justification of taxation must rest on the will of the people expressed by legislation: when its results are applied otherwise than for the good of the general public, taxation can no longer be defended.

Sometimes taxation is used for restrictive purposes, as in the case of the whiskey taxes or for other incidental public objects. Nevertheless, the function of taxation is the raising of revenue, and not the indirect attainment of public benefits. Hence, while taxes may be imposed with the idea that some reform will be promoted, or that protection will be given to industry, or even that a re-distribution of wealth will result, the primary end and test must in every case be the effect in raising revenue.

2. Taxation and Public Incomes

Taxation furnishes, at present, the chief source of national income. Public revenues are derived from taxes, public industries, public domains, fees, special assessments, and miscellaneous revenues, such as fines and penalties supplemented, if need be, by government loans. Originally governments were presumed to be self-supporting, and all legitimate expenses were expected to be paid out of revenue accruing from public industries, fiscal monopolies, or other analogous sources of income. When taxes were levied, they were regarded as special sacrifices on the part of the citizens, to aid the state in some military or financial crisis, with the expectation that after the occasion had passed the taxes would be abolished.

The change in importance of taxation as a source of public revenue has paralleled the abandonment of the original idea of taxes as gifts, and at the present time nations derive the largest part of their income from this source. In the United States, receipts from the sale of public lands are no longer important in the annual budget, and public industries, in so far as they exist at all, are relegated to municipalities and other subordinate divisions of government. Fees and special assessments are always negligible, and in many cases hardly cover the cost of the service for which they are required. Some countries, notably England, make large profits from public service, such as the postal department, but in the

United States it has always been the policy to furnish such utilities at cost price. Government loans, while a current source of revenue properly chargeable to income, nevertheless represent deferred taxation, since they must ultimately be paid out of that or other forms of income. Taxes remain as the chief resource of the public financier. Whether in the form of direct taxes, or of excise and customs duties, they furnish the only income susceptible of exact control. Other forms of revenue fluctuate to a considerable extent, or are of so little importance that they cannot be counted upon as an appreciable part of the national resources. The yield from taxes, on the contrary, can be increased or decreased at will, and they accordingly furnish the most convenient and lucrative element in public finances.

While it has already been shown that the purpose of taxation must in every case be for the public good, discussion may arise as to the nature of that good in its relation to the person assessed. From the point of view of the taxpayer as an individual, a tax is a legal exaction for which he receives no direct return. He is supposed to pay a sum proportionate to his ability, regardless of the actual benefit that he receives from the activities of the state, and the tax represents by no means a quid pro quo. From this standpoint, any form of direct taxation is nothing more nor less than an enforced levy, arbitrary in its nature, and independent of intrinsic justice. As a member of society, however, the attitude of the individual must be entirely different from that which he adopts if he looks upon the tax as a cost or expense to himself. From the social point of view, the taxpayer is the recipient of benefits as one of the community and not as an individual; the return from his payment of taxes cannot be reckoned in dollars and cents. As a social unit, his contribution is merged in the contributions of others, and he partakes of the advantages which society as a whole receives from the payment of taxes, regardless of the relative size of his share. The justice of this argument for taxation rests upon the solidarity of social interests and upon the fact that public wants cannot be segregated or specialized to individuals. The state is an organic whole, rather than an intrinsic unit that may have interests different from those of its citizens. The prosperity of the citizen is dependent to a large extent upon the existence and growth of the state of which he is a member, and it is just that he contribute to the furtherance of its objects.

3. Limits of Taxation

While in general it may be said that the limits of the power to tax are indefinite, so long as the tax is levied for a public purpose, yet there are several legal or economic determinants which control its exercise. It is an established fact that the power to tax involves the power to destroy. This means that there is no legal limit to the power of the state to exact contributions from property owners, though taxation must not encroach upon the rights of citizens, whether it take the form of discrimination by one state against citizens of other states, or of violation of constitutional guarantees protecting its own citizens. Again, the exercise of the taxing power must not impair the obligation of contracts. This represents merely an individual case, under the rule that rights and privileges of citizens must not be impaired. In general, it may be said that the taxing power is limited by the provisions of state and federal constitutions. These limitations are concerned with methods of levying taxes, and purposes for which they are raised, rather than with the amount taken.

Economic considerations play an important part in determining the expediency of the given form of taxes. Not only must taxes be levied in accordance with law, but they must be laid in such a manner as to cause the least hardship to taxpayers. When a tax has been enforced for a period of years, industrial conditions become adapted to the system, and revenue is collected without appreciable disturbance. On this account it has been said that all old taxes are good taxes. Nevertheless, it should be borne in mind that in spite of the adaptation of the community to the tax system in vogue, its inherent justice remains the same as at the time the tax was new. Especially must care be taken that a tax does not ultimately impair the aggregate capital of the nation. If taxes are laid in such a way that their bearers draw from capital, and not from income, it is evident that capital must ultimately be diminished, and the source of revenue at last exhausted.

4. The Public Good

Another factor in the assessment of taxation involves the opposition of public good and private enjoyment. When taxes are levied for public purposes, a balance must be struck between the benefit of the general activities which it makes possible, and the hardship to the individual who contributes toward those activities. Obviously, when the exactions from the taxpayer go to the support of those functions of government which secure the enjoyment of life and property, considerable sacrifice may

reasonably be demanded, and he may be required to curtail his luxuries to a large extent in order that he may enjoy these fundamental rights. When on the other hand taxes are assessed for the purpose of creating some public luxury, such as parks, it becomes pertinent to inquire what sacrifice the citizen must undergo in order to permit these enterprises. If taxation requires a restriction of the necessary expenditures of the citizen and a lowering of his standard of living, it is certain that the money had best be left in his hands. When aggregate enjoyment is secured at the expense of the industrial efficiency of the unit, it needs no argument to show that such taxation is unwise.

The reverse case may also be true ; taxes may be too low as well as too high. Such would be the result if legitimate and necessary expenditures of government were restricted in order fully to secure to the individual the maximum enjoyment of his possessions. Thus protection against crime or losses by fire might be sacrificed in order to lighten the burden of the taxpayer. No better general rule can be formulated than was that laid down in the first constitution of Pennsylvania, adopted in 1776: "The purpose for which any tax is to be raised ought to appear clearly to the legislature to be of more service to the community than the money would be if not collected."

CHAPTER II
INCIDENCE OF TAXATION

WHEN a tax is levied it is essential to determine upon what portions of the community the burden will ultimately fall. Not only is this necessary in order to secure justice, but it is equally important on economic grounds. If this consideration were neglected, certain portions of the community might be overburdened by levies to a point where their industrial efficiency would be lessened, while other portions might escape almost entirely. The problem of incidence is the determination of the individual or the class which ultimately pays a given tax. This does not refer to the person upon whom the tax is first assessed, for wherever it is possible to add a given tax to the price of the commodity upon which it is levied, the original payer will shift the burden upon the consumer. The problem involves rather the determination of the person or the class which is no longer able to shift the tax. Is it one industrial class, or is the burden borne by all, in approximately equal shares?

1. Various Views of Incidence

The older economists held that a single class ultimately bears the entire loss. This view is known as the concentration theory of incidence. According to some, the landlord is necessarily the only contributor to governmental revenue, since every other class shifts the burden of taxation until it comes to him. It was urged that the laborer cannot bear the tax because he has no income over and above the bare wages of subsistence; that the trading portion of the community will not bear it, since it is able to include the tax in the price of articles sold; and that hence the landlord remains as the only logical person upon whom it can rest. According to others, the moneyed class, rather than the landowners, finally paid the full assessment.

Succeeding this period of thought, when the concentration theory of the incidence of taxation was prevalent, a more optimistic school, headed by some of the modern economists, notably David A. Wells, was inclined to the belief that regardless of the original imposition of taxes, ultimately all classes share alike in their payment. It was believed by these writers that the burden of taxation is constantly shifted from one class to the other, and that ultimately each individual of the state pays a share of the general expenses, either as a producer or as a consumer. This is the so-called

diffusion theory of incidence. The doctrine that old taxes are better than new, and that all old taxes are good taxes, was evolved out of this theory, and resulted in a superficial optimism as to the assessment of taxes. According to this doctrine it makes no difference what class of persons pays the tax in the first place, since it is finally shared by all alike.

Certain defects and evident falsities in both of these theories have led to the general acceptance of the eclectic or definitive theory of incidence. This modern theory maintains that the conditions under which the taxed commodities are produced determine the possibility of shifting and the final incidence. According to the conditions of production articles may be divided into three classes: (a) articles produced at a constant cost; (b) those made at an increased cost under the law of diminishing returns; (c) those manufactured under monopoly conditions, or subject to the law of increasing returns. The incidence of taxes on articles produced at a constant cost will be different from that on goods subject to the law of diminishing returns; and the incidence of taxes on commodities manufactured under monopoly conditions, or subject to the law of increasing returns, will be different from either.

2. Articles Produced at Constant Cost

Considering first the case of articles susceptible of indefinite multiplication without increase in cost, the general rule is that normal price approximates the cost price. That is to say, in the case of goods such as most of the textiles, where the cost of manufacture remains the same whether the output is large or small, after a certain point securing the profits of large-scale industry has been reached, the market price of those goods will average about the physical cost of production plus a small margin of profit. This is so because competition among producers will cut profits down to the lowest point consistent with the continuance in business of the weakest among them. If, now, a tax is levied upon the articles of this trade on all producers alike, it must be represented in price. Under these conditions, the tax enters into the production of the goods in much the same way as do wages and raw material, being common to all. The cost of production then is arbitrarily raised by the amount of the tax; inasmuch as all goods sold for the lowest price consistent with the continuance in business of the weakest producer, before the imposition of the tax, if that weakest producer is to remain in business, the price will be raised by the full amount of the tax, and accordingly the tax will be shifted to the consumer.

If the demand for a given article is constant and is not affected by the rise in price, then the entire amount of the tax will be shifted, since the same producers are in business now as before, and the net result of the tax is an increase in cost of production. If, however, the demand shrinks on account of the rise in price, the producers have the option of assuming part of the tax and maintaining the proportion of sales, or of shifting the entire tax upon the consumer and selling fewer goods. If the producers elect to pay a portion of the tax at the outset, the weaker competitors will be driven to the wall, as they were barely able to continue in business before the imposition of the tax. There will, then, be fewer producers, and since the customers of their former competitors must now buy of them, there is a demand greater than that which they previously supplied. By raising the price to the full extent of the tax, they will then decrease the demand approximately to the point which they formerly supplied, and as a net result they will have shifted the entire tax on the consumer. Hence it is that the consumer finally pays the tax on goods of this sort, although the producer may elect to assume a portion of it for awhile.

3. Articles Produced at Increasing Cost

The next class of cases to be examined presents the phenomenon of commodities susceptible of an indefinite multiplication, but at an increasing cost. Goods of this sort may be produced indefinitely, but the first unit is manufactured at a smaller cost than is the second. Agricultural products are typical of this class, as this principle, the so-called law of diminishing returns, is here presented in its purest form.

In agriculture, as a rule, the richest land is used first, and cultivation is then extended to the soils of lower grade. Ultimately, there comes a time when further efforts in taking up poorer soil will be unprofitable, since the return from these lands does not yield a profit. When demand for the particular crops that alone can be raised on such soil increases on account of growth of population, then these poorer lands may repay the efforts spent upon them. At a given stage of progress in the community there is always land of a grade of fertility which just pays expenses of tillage, while land below that grade is not worth the employment of capital and labor upon it. All the higher grades of land are now paying a differential return, or economic rent, since it is evident that fertile soils will yield a larger and more valuable harvest in return for a given expenditure of time and money, than will these poorer lands which are still profitable.

Considering now that the cultivation of these poorer lands is justified by a fairly constant demand, as is necessarily the case with food products, the price of these crops is fixed not by any average cost, but by the expense of production on the poorest lands that can profitably be kept in use known as the margin of cultivation. All crops produced on the better lands cost less than do those on the margin of cultivation, in proportion to the relative fertility of the land. The cost is least on the best lands, and increases until the margin is reached. Hence all the more valuable lands will yield a differential return, or economic rent, proportionate to the cost of production upon them, as compared with the cost of production upon lands at the margin of cultivation.

Now, if a tax is levied upon all land alike, in proportion to acreage, it will, as in the first class of cases, enter into the cost of production as a permanent factor, since the cost at the margin of cultivation is raised to that extent, and accordingly, as in the former case, it will be shifted upon the consumer. If, however, a tax is levied upon the products of land so that the differential profits only are affected, then the cost at the margin of cultivation remains the same, and the tax cannot be shifted. This is so because a tax on the differential gain is a tax upon an economic surplus which the owner of the better lands enjoys, and which is not a factor in the cost of the product. Therefore, taxes on land may be shifted if they are levied in such a way as to affect cost at the margin of production, and cannot be shifted if they are assessed simply on differential profits from land. The same considerations hold true of manufactured articles wherever the law of diminishing returns operates; i. e., wherever one manufacturer enjoys an advantage in the cost of production not available to others whose plants simply justify operation.

4 Articles Subject to Monopoly

The third and last class of cases is that of goods produced under monopoly conditions, or where the law of increasing returns is a factor. Two types of monopoly must be examined. The first presents the situation where the industry is free from competition on account of possession of patents or other advantages not available to competitors. Here the price is always fixed as nearly as possible at that point where the largest returns will be secured. This point is ascertained by considerations of price, demand, and cost of production. By hypothesis, the cost of production may be the same for the output of a large number of articles as for the production of a small

number, or the cost of a larger number may be relatively lower than that of a smaller number.

Supposing, in the first place, that the cost remains the same, it is evident that if the goods are sold at a low price the total number of sales, other things being equal, will be greater than would be the number of sales at a higher price. Every time the price is lowered, more articles are sold, and every time the price is raised, the demand falls off. It follows that there must be a point at which maximum returns are to be obtained; a further increase in price would lessen demand to such an extent that the net profits would not be so great as they would be were articles sold at a lower price, while a further decrease in price, though increasing the demand, would nevertheless bring the margin of profit on each sale so much nearer the cost of production, that the net profits would again fall off. The same result holds true if the goods are produced at a decreasing cost of production. The only difference in such a case will be that prices may be reduced for the purpose of supplying a larger demand, to an extent greater than that possible if the cost is constant.

If, now, a tax is levied upon an article produced under these conditions, it will necessarily enter into the cost of production, and the balancing must take place again, with the higher cost of production to be considered. The price will still represent the point of largest net return to the manufacturer, but this point may not be inconsistent with the assumption of a large portion of the tax by him. If he attempts to shift the entire amount of the tax upon the consumer, then the price may be so greatly enhanced and consequently cause demand to fall off to such an extent that it would be more profitable for him to assume the tax himself, and thus keep up the demand. Whether he will do so or not will depend largely upon the elasticity of demand. If the demand is constant regardless of price, obviously the producer will shift the entire burden of the tax upon the consumer, since a certain amount of the goods in question will be bought in any case. Demand, however, is generally more or less elastic and in that case the shifting of the tax will be governed by the principles determining the point of highest net return. If the demand is quite elastic, and a small increase in price would necessitate a tremendous falling off in demand, the manufacturer must bear almost the entire tax himself, as otherwise the return from the demand still remaining after the increase in price would not be commensurate with the return from the larger demand at the old price, even after the amount of the tax is deducted. It may be laid down as

a general theory then that in these cases if demand is elastic the tax will be paid in large portion by the producer, while a more constant demand will tend to shift the tax upon the consumer.

The second case is that of a monopoly dependent upon the nature of the industry. Here the monopoly owes its existence and continuation not to any legal or physical impossibility of competition, but to the fact that it is operated under the law of increasing returns; a large output costs less relatively than does a small one. In this connection, railroads may be taken as typical. A small railroad cannot successfully compete with a larger, because profits are dependent upon the operating ratio, and expenses do not increase proportionally with increase in volume of business.

Suppose now that a tax is levied upon a business of this sort. It enters, of course, immediately into the cost of production, or to continue to use the case of a railroad, into the expenses of operation. Here, not only is the net income reduced after deduction of expenses, but the rate of profit itself is reduced. As such a business depends for its success upon the amount of business done, or upon the volume of traffic, it is not in a position to risk a falling off of demand. Loss of trade in this case means more than it does to a monopoly which secures its profits by impossibility of competition, for the reason that if a monopoly of the second sort attempts to throw the burden of the tax upon the consumer, not only do its sales fall off, but at the same time its rate of profits decreases. It is dangerous for such a monopoly to adopt measures that are likely to cause a diminished demand, because the rate of profit may be affected in such a way as to disappear entirely and to turn into a deficit. This result is so likely that the entire business would often be put in jeopardy by an attempt to shift the tax, and it is usually the best policy for the producer to assume the entire burden of the tax, rather than to throw any of it upon the consumer.

CHAPTER III
JUSTICE IN TAXATION

AS in the exercise of other functions of government, it is essential in taxation that the burden shall fall as equitably as possible on all classes of subjects. If a particular class is taxed beyond its just share in supporting the burdens of the government, and another class is exempt, it can readily be seen that the efficiency of the industrial organism will in time become impaired. Accordingly in distributing the tax burden, the financier must endeavor to have it fall as evenly as possible upon all classes of society.

1. Proportional Taxation

It is argued by some that justice demands that taxation should leave the several industrial and social units in the same position in which it found them. In other words, the relative wealth of the various classes should remain the same after taxation as it was before. In accordance with this theory of justice, it is urged that all taxation should be proportional; i. e., that it should take the same relative amount from the poor as from the rich man, thus exacting a constant percentage regardless of the amount of the property subject to taxation.

This conception of ensuring equal justice in taxation has generally been advocated by those who have held some kind of a benefit theory of taxation. They insist that after the imposition of a poll tax as a return to the state for protection of life and liberty, property should be taxed at a constant rate, because the larger estate receives a relatively larger amount of service from the state through fire and police protection. This is true in a measure only, since it by no means appears that it costs the state ten times as much to protect a holding worth ten thousand dollars as it does one of a value of one thousand dollars; and the position is so far from mathematically right that its value as an argument is sensibly diminished.

The most scientific advocates of this scheme of taxation insist rather upon certain defects in other proposals than upon any direct arguments for the inherent justice of this sort of taxation. From a positive standpoint they claim that general governmental services should be paid out of taxes levied on the subject's net resources, and as these net resources, whether large or small, are affected alike by the exercise of the functions of government, the only proper basis is a definite percentage of all incomes. Nevertheless, even the most ardent supporters of this doctrine, agree that when special

services are rendered by the government, those who receive the benefits should pay in return a definite sum commensurable with the service given. In this way, they claim that necessities would escape nearly all except the direct proportional tax, while luxuries might be made to pay an additional tax.

2. Progressive Taxation

Certain defects in the justice of proportional taxation have inclined one school of economists to support progressive taxation. Under proportional taxation, it is plain that the burden borne by the working class is heavier than the burden upon the wealthier class. If a definite percentage of income is taken, regardless of its size, in most cases a tax of one hundred dollars will bear more heavily upon an income of one thousand dollars, than will a tax of one thousand dollars upon an income of ten thousand dollars. In the first case, the one hundred dollars taken from the thousand dollar income represents a sacrifice of necessities, whereas the larger tax on the larger income will represent merely a forbearance from certain luxuries. When an income increases to a vast extent, it is possible that a ten per cent tax will not be felt at all, since it is impossible for the owner to spend it on even the most extravagant means of enjoyment. In reply to this conception of the ability of the individual to pay taxes, it is often urged that as a man's income increases, his wants likewise increase, and that it is just as hard for the more prosperous man to sacrifice a thousand dollars as it is for the poorer man to pay one hundred dollars. Within certain limits there may be truth in this assertion, but when those limits reach the consumption of necessities or even of common comforts on the one hand, and the huge income which cannot be consumed on the other hand, the theory seems to have no application.

The advocates of progressive taxation, whereby larger incomes pay a larger proportion of amount than do the small ones, rest their case upon the fundamental idea that taxation is levied for the good of society as a whole, and not in return for benefits given by the state. Inasmuch as the object of taxation is the greater efficiency and prosperity of the community, every one should contribute toward the efficiency and prosperity in accordance with his means. As the wealthy man can spare a relatively greater amount of his income without feeling the loss than can the poor man, it follows that the larger income should furnish a relatively larger share of the entire revenue.

Progressive taxation is a favorite expedient of those who wish to secure a better distribution of property, and has certain good points in so far as it relates to inheritance taxes, especially where unearned masses of capital are involved. When, however, it deals with the taxation of incomes the proposal involves a socialistic view of the entire organization of industry and is accepted only by those who hold this view.

3. Equality of Sacrifice or of Faculty

The advocates of the theory urge its justice on grounds of equality of sacrifice or equality of faculty. Under the theory of equality of sacrifice, the old question of the relative hardship of paying a fixed proportion of income is revived. Inasmuch as the larger income in most cases can bear the loss of a larger proportion than can the smaller, taxes should be so adjusted that the rich man and the poor man shall feel their respective shares of the burden to the same extent. The man with an income of ten thousand dollars can oftentimes spare two thousand dollars more readily than the man with an income of one thousand dollars can spare one hundred dollars. To be sure his luxuries are considerably cut down, but the economic suffering caused by the deprivation of those luxuries is incommensurate in many cases with the denial of necessities. Equality of sacrifice, then, means that all classes of society should feel the tax burden equally, and one should not be put to greater inconvenience than another. More scientific perhaps and more closely connected with the social service theory of taxation is the doctrine that taxes should be laid in accordance with the ability of the taxpayer to bear them regardless of the inconvenience involved. As all are benefited by the governmental activities, each one should pay what he is able in order to secure those benefits to the community. This idea is analogous to the "equality of sacrifice" doctrine, but while it works out in much the same way, it rests on a firmer basis in relation to the fundamental justification of taxation.

It is objected to progressive taxation that it must necessarily be arbitrary, because it is as impossible to measure equality of sacrifice or of ability, as it is to measure benefits received. It takes the same increasing proportion from an income derived from industry and the exercise of skill, as it takes from a vested income independent of the exertions of the taxpayer. A vested income, for instance, may be hereditary and may descend to the heirs of the person taxed, whereas an income based upon economic efficiency is dependent upon the continued exertions of its possessor, who

must save for the support of his family after his death. In such a case, tested both by equality of sacrifice and equality of faculty, it is evident that the two money incomes are not by any means equally capable of bearing a given tax. Up to the present time, however, it has never been attempted to draw a distinction between types and sources of income in the levying of progressive taxes, and the problem involves obvious administrative difficulties.

Again, it is urged that progressive taxation tends to discourage thrift and to check saving. If the individual recognizes that an increasing proportion of his earnings is to be taken for the support of the government, he is not so likely to make increased endeavors to enlarge his income as is the case when he secures the entire benefit of his greater activity for himself. Analogous to this objection to progressive taxation is the fact that it is likely to cause an evasion of taxes or emigration of capital to a locality where it is more favorably treated. On the whole, any progression in taxation must be slight, in order to avoid these results. Furthermore, a minimum should always be made exempt, for it is evident that the laborer cannot pay taxes until he has first made his subsistence expenses. Especially must care be taken to avoid too rapid an increase in rates, for there is likely to be a tendency to make large incomes bear a greater relative proportion of the taxes than is just, and in some cases the rapidity of this increase amounts practically to confiscation.

4 Utilization of Social Products

A third leading theory as to the justice of taxation is that of Henry George, who promulgated the idea that inasmuch as the rent of land is entirely a social product, it should be returned to the community in the form of taxation. The doctrine rests upon Ricardian reasoning and may be formulated as follows: Rent does not rise until different grades of land are in use, measured either by fertility or by site value. The differential return on the more valuable lands is accordingly a result of the growth of society which has necessitated the cultivation of the inferior land. Were it not for the existence of civilization, there would be no rent, as the few persons inhabiting a given country could all find sufficient soil of the best quality. Hence it may be said that rent is a social product. Arguing from this premise Mr. George and his followers claim that the natural as well as the most just taxation would consist of a repayment to society of this value which it has created.

Objections to the theory generally rest, not upon any inherent imperfection in the scheme itself, but on doubts as to its practicability. Were all land at present free, there are few who would hesitate to allow the justice of this method of taxation; but land has so long been considered as private property that it is now classed with stocks and bonds and other general property, the results of industrial efforts. Many who have made money through legitimate industrial activities have invested the proceeds in land and real estate rather than in commercial enterprises. The injustice of taking the entire proceeds of such investments, to the advantage of those who have happened to invest in personalty seems at first thought not to admit of doubt. On the other hand, should any differential gain due to the progress of society after the purchase of a given parcel of land be taken for the benefit of the society which created it, no injustice whatever can be urged, since the product is purely social and independent of the efforts of the owner of the land. In assuming the justice of the theory, then, careful consideration must be given to the circumstances under which the land was acquired. Where the rent represents a social product accruing since the last sale of the land, then surely such differential gain properly belongs to society, and is now held by the proprietor as a sheer gratuity.

The chief difficulties with the land tax proposal seem to center about the possession of present owners, and the problem of compensation to those holders of property whose lands are but a converted form of industrial production is one of the most formidable involved. The seeming injustice is, however, materially mitigated when it is remembered that an investment in land is tax-free at the time of purchase, so that injustice would not really set in until a new tax upon it should begin to exceed the rate borne by the land when bought.

CHAPTER IV
CONSTRUCTION OF A TAX SYSTEM

IN the construction of a tax system the first essential is financial productiveness. Matters of the proper distribution of the burden or of the final incidence of a given tax are subordinate to the all-important factor of fiscal adequacy. It is not true, of course, that the best tax is that which is most easily raised, as was the statement of prominent fiscal ministers in years gone by, but their assertions carry with them considerable weight in drawing attention to the fact that until the treasury is filled questions of justice must wait. The first consideration in the levying of any tax concerns the amount of revenue to be expected from it, and unless it is able to fulfil this requirement satisfactorily, its value as a tax is slight.

1. Some Rules of Taxation

A corollary of this requisite is the rule that the tax must take as little as possible from the taxpayers over and above the amount which goes into the treasury. Taxes may yield a large return, but if the cost of collecting them is heavy, then some other tax yielding a smaller gross return is more desirable.

In the processes of taxation the industry of the nation must be disturbed no more than is necessary. When the productiveness of a given tax is satisfactory, the next consideration is the effect which any proposed change will have upon industrial activity. Undue restrictions must not be imposed upon capital, if its emigration to neighboring countries is possible. Where capital can readily be converted from one form of investment into another, as soon as revenue exactions upon it become irksome it will promptly desert the country imposing such restrictions, and will move into neighboring and probably competing states. Especially is this the case in the American States. On slight provocation, capital will betake itself into other states. As a result, the tax laws of the various states often present an undignified subservience to capital, in order to secure its location or continued presence within the state.

The political effect of a given tax also has to be considered. On the one hand there is the social question of educating the citizen to a realization of his duties toward the state by letting him know the exact amount of the direct tax which he pays. On the other hand, indirect taxes are often more conducive to the stability of administration, since a realizing sense of the

actual tax burden would in many cases raise an outcry against the burden of a levy which if collected in the form of an indirect tax would pass unnoticed. The first alternative, that of making all taxes direct, would result in greater public economy, since each member of society would see the effect of disbursements reflected in his own tax bill. Yet this economy might result in a reluctance to spend public money even for necessary improvements. So it is that the popularity of a given tax must be taken into account, or the government may find itself confronted by opposition.

2. Adam Smith's Maxims

The various questions arising in the construction of a tax system are recognized in the maxims formulated by Adam Smith.

First: "The subjects of every state ought to contribute toward the support of the government as nearly as possible in proportion to their respective abilities." The problem, of course, arises here as to whether this payment in proportion to ability is best secured by proportional or progressive taxation. This is a matter for every state to decide for itself, and the attitude adopted varies greatly. Nevertheless, whatever may be the best means of securing payment in proportion to ability, it is generally agreed that this is the proper standard or principle of contribution to the support of government.

Second: "The tax which each individual is bound to pay, ought to be certain, and not arbitrary." In order that the state may secure a maximum of revenue at a minimum expense, it is necessary that the taxpayer shall be able to understand and discount the tax before it is levied. In those countries where tax-gatherers have "farmed" the revenue for the government the canon of certainty has been neglected with disastrous results. Taxation in such case is arbitrary and not certain; the tax-gatherer is obliged to make a certain return to the public treasury, but what he can collect over and above this amount goes as profit to himself. Accordingly he makes the rate of taxation as high as is consistent with its collection, regardless of its effect upon national industry. When it is definite and certain that a tax of a given amount will fall due at a specified time the taxpayer is able to discount the levy to a large extent, and regulate his business accordingly. Where, however, the amount of taxation is not known or anticipated, the levy must cause disturbance to business and pressure upon all.

Third: "Every tax ought to be levied at a time, or in a manner, in which it is most likely to be convenient for the contributor to pay it." This canon deals primarily with loss likely to result in the process of collection. If the tax is paid at the time when the taxpayer is best able to pay it, obviously the net revenue turned into the treasury will bear a greater proportion to the gross expense of the community than will be the case if the individual is obliged to save a portion of his income for considerable periods of time in anticipation of taxes. All capital not needed for purposes of assessment can immediately be turned over, while otherwise a portion must lie idle in anticipation of it.

Fourth: "Every tax ought to be so contrived as to have to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state." This canon emphasizes the desirability of reducing the cost of collection to the lowest point consistent with the best interests of industry. An army of tax-gatherers and collectors always represents a net loss to the community, as their labor is of the least productive sort. Whenever it is possible, therefore, to lay a tax that will result in a decrease of the number of agents necessary for its enforcement, it is advisable to do so. Again, this canon deals with the obstruction of industry in practically every form. Where industrial activities are hampered by the imposition of certain kinds of taxes, that hindrance must be considered in terms of value, and every such obstruction finally results in a certain amount of national loss.

In addition to the canons of Adam Smith, certain other rules, which may be derived as corollaries from these maxims, should be followed.

Systems of taxation should be intelligible to those who operate under them, and the general incidence should be traceable with some degree of certainty. Next, a tax system should be elastic, making the annual revenue adjustable to the varying public need. Expenditures are governed by wants, rather than by the tax roll, and accordingly the revenue should be readily conformable to the needs of any particular budget. Finally, taxes once imposed should be retained as long as they are capable of satisfying the purposes for which they are levied. A new tax is always an unknown quantity and considerable time must elapse before industry is able to adjust itself to its provisions. An old tax, on the contrary, has long been discounted, and industry is carried on with reference to its incidence, so that it has little practical effect upon business; a new tax, however, is a

disturbing factor in the organization of industry and one that cannot be discounted immediately.

3. Single Tax or a Multiple Tax

It is important to consider whether the requirements of the situation are best met by the adoption of a single tax or by numerous taxes upon various kinds of property. By a single tax is here meant any tax which bears upon only one type of income or property. At the first glance, it seems obvious that a single is preferable to a multiple tax system, since its incidence and effects are more easily calculated. Such a tax, it would seem, could be more easily apportioned in accordance with the intent of the legislature, and would be more easily understood and estimated, than a multiple tax system which is necessarily empirical. Such a tax would cost less for collection, compared with its net yield. In view of these advantages of a single tax, how does it happen that nearly everywhere a multiple tax system is in vogue?

One obvious reason is that, with the possible exception of a single tax upon land, such taxes are paid with the least complaint. As taxes that are levied upon all articles in the course of production are actually paid over by the producer, the average consumer does not recognize the tax in the enhanced price he has to pay for a given article, and thus through lack of understanding he is less likely to contest his tax bill.

If, on the other hand, he is forced to pay a certain net proportion of his income every year he instinctively protests at once against the enormous dimensions of government expenses. In the case of indirect taxes it is not easy for a man to analyze and summarize the actual burden which he bears.

Again, it is urged that justice is best secured by a multiple tax system. If a direct tax is levied upon any one class of property, there must be various kinds of wealth which entirely escape. For example, suppose the present general property tax were used exclusively as a single tax. It is notorious that under it as now administered much property would escape on account of the impossibility of finding it unless the taxpayer voluntarily produces it. Real estate is not able to escape taxation, as it is in plain sight, but personal property to a large extent successfully evades taxation. The wealth represented by this personalty is bound both legally and morally to contribute to the support of the government, as much as is the realty, but obviously it will not do so unless its owner is honest to an exceptional degree.

This defect is common to all direct taxes as at present administered. The advocates of the single tax upon land claim immunity, but the current view of administrators of public revenue does not recognize the distinction and puts all single taxes in the same category.

As a corollary to this main argument it follows that a larger amount of revenue can be realized through a multiple system. If some incomes escape under a single tax, a multiple system will, no doubt, partially reach them and will promote justice, at the same time yielding a larger revenue to the state. Under any scheme of direct taxes, no attempt is made to reach the smallest incomes, but small incomes are as amenable as large to a tax disguised in the price of the necessaries of life.

Finally, in the United States it is a factor of no mean importance that the federal and state governments are dependent upon separate sources of revenue. The federal government makes up its budget from indirect taxes, levied in the form of customs and excise duties. The state governments, and their sub-divisions, on the contrary, pay expenses out of direct taxes.

4 Direct vs. Indirect Taxes

A multiple tax system might be constructed by the use of various methods of direct taxation, but in practice resort is had to both direct and indirect taxes. Direct taxes are those which are intended to be paid by the person or persons upon whom they are levied; indirect taxes are intended to be paid only in the first instance by those upon whom they are levied, and afterwards shifted upon the consumers of the articles taxed. Direct taxes are taxes upon outstanding possessions, while indirect taxes are taxes upon new acquisitions.

The chief arguments in favor of indirect taxes rest upon their productiveness and the fact that they are made to reach incomes which must otherwise escape. As already intimated, an indirect tax is able to reach practically every possession or income. In any state, the bulk of its revenue is not secured from the larger holdings of property; it is always the aggregate of moderate or small incomes which go to make up the largest portion of receipts. While certain taxes on large fortunes, especially where progressive taxation is in force, seem to amount to tremendous sums, nevertheless these large fortunes contribute a relatively smaller part of the revenue than might be supposed. Whether justice is best secured by taxing the necessaries of the working man is a question for argument, but at any

expenditure is encouraged, when the exact share of the tax burden borne by each taxpayer is not brought home to him.

These disadvantages may be met in some degree by following the canons of taxation as to convenience and certainty, but in any case the operation of indirect taxes must be empirical. Knowledge of the incidence of taxes allows direct taxes to be traced with considerable certainty to their ultimate payers. Indirect taxes, on the contrary, rarely admit of accurate forecasting in regard to their incidence, and on this account cannot be considered as scientific as direct taxes.

CHAPTER V
NATIONAL, STATE, AND LOCAL TAXATION

UNDER the Constitution, Congress has power "to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defense and general welfare of the United States, but all duties, imposts, and excises, shall be uniform throughout the United States." This power is limited by the proviso: "No capitation or other direct tax shall be laid unless in proportion to the census or enumeration hereinbefore directed to be taken. No tax or duty shall be laid on articles exported from any State." These articles of the Constitution are the source of all federal power of taxation. It becomes important to analyze the provisions, to determine what purposes of taxation are permissible, and what restrictions are placed upon the exercise of the power.

1. Limitations of Taxing Power

Taxes may be levied to pay the debts of the nation, to provide for its defense, and to secure its general welfare. The meaning of the first two provisions is evident, but it is a matter of some difficulty to select the governmental enterprises that are most conducive to the "general welfare." It is for the legislature to decide what such purposes may be, and only in extreme cases will the courts interfere with its decision.

What the Constitution intended by the term "direct taxes" has been much discussed before the courts. In its first decision the Supreme Court held that the term was to be taken in a narrow sense, practically recognizing only two classes: taxes on land and capitation taxes. This opinion has since been overruled, and the term is now held to include income taxes, regardless of the kind of income upon which they are levied. A constitutional amendment was, therefore, required to authorize Congress to enact the income tax provisions embodied in the new tariff act. A succession tax would probably come under the category of direct taxes as at present interpreted. It is well settled that a tax on the circulation of state banks is an indirect tax.

In the case of indirect taxes, the requirement of uniformity is satisfied when all taxable articles of the same class are taxed at the same rate, and no distinction is made on account of the condition or situation of the bearer of the tax.

In keeping with the division of sovereignty between national and state governments, it is essential that each shall have a separate field of taxation, not trenched upon by the other. The constitutional province of the national government is that of indirect taxes, and the national policy has been to secure the bulk of the revenue from that source. Only a few times in the history of the country have direct taxes been levied. The most important of these, if we except the present income tax, were those imposed during the Civil War. The convenient requirements of adequacy, suitability, elasticity, and efficiency seem to be best met by placing the main reliance upon indirect taxes. Adequacy is obviously satisfied, as a glance at the enormous annual totals of revenue from customs and excise taxes will show. In regard to suitability, it is impossible for the states to lay effective excise or import duties, since such an attempt must result, as it has resulted in the past, in the migration of capital and shipping to states having more favorable though less efficient tax laws. Efficiency appears in the superiority in method of administration by the national government, which it would be impossible for any single state to attain.

2. Customs Duties

Customs duties perform a double function: they serve as a means of revenue, and also as a protection to domestic manufactures. As this treatise is concerned only with the raising of revenue, the protective feature need not be discussed, but it may be noted that a system of duties designed to secure revenue must differ essentially from one intended to protect domestic industry. In a purely revenue tariff, luxuries will be taxed, together with a few staples commonly imported; in a purely protective tariff the revenue-yielding qualities of luxuries and staples will be neglected, and the tariff will affect only those products which seem to require the protection of a tariff wall. In the United States the tariff has been framed to secure both objects, and between the two functions protection has beyond doubt received its full share of attention. From one-third to two-thirds of the entire revenue of the government has been obtained from customs duties, which amounted in 1912 to $311,321,672, while the protective character of the tariff has been plainly visible in its operation. The disadvantage of an attempt to combine the two systems, is becoming more and more evident, and it is to be hoped that if the policy of protection continues, certain articles will be protected as such, without regard to their revenue-producing qualities, while other articles will be

chosen as the subjects of customs duties on account of their revenue-producing qualities alone.

The shortcomings of a combination policy are shown in the sugar tariff under the Payne-Aldrich act. While raw sugar has yielded in the neighborhood of fifty-two millions of dollars annually, accurate computations indicate that the tariff raised the price to the consumer nearly double that amount, the larger portion of the second fifty millions finding its way into the pockets of domestic and Cuban producers and a smaller portion into the treasury of the Sugar Trust. This case looks like a prostitution of the taxing power. For the sake of raising fifty millions of dollars for the Government, the consumer is subjected to a tax of a hundred millions of dollars. Such methods of securing revenue and protection at the same time secure no commensurate return, and tend merely to increase the cost of living.

A couple of centuries ago the revenue accruing from customs was supposed to be an unmixed blessing. Prominent economists held that the burden of a customs tax falls not upon the consumers of the importing nation, but rather upon the foreign producers, who, it was assumed, paid the full amount of the tax. With a larger knowledge of the incidence of taxes it has become clear that it is the consumer upon whom the entire amount of the customs duties must ultimately fall, except in the case of imported articles manufactured under monopoly conditions abroad. Accordingly, any government which levies customs duties, must proceed upon the assumption that its subjects will pay the tax in most cases, and it must consider what effect this fact will have upon domestic industry.

It has been said by American business men, that they are able to thrive under any tariff, as long as they are able to discount it sufficiently in advance. This suggests the idea that customs duties should, above all, be stable. There is no danger so insidious as that of a constantly shifting tariff. When a given tariff, no matter how unfavorable its provisions may be, has been in effect for a considerable length of time, industry has adapted itself to conditions, and is able to proceed on the most remunerative lines. When, however, the tariff policy is constantly shifting, not only does the actual fact of such shifting cause a constant fluctuation in business enterprises in an effort to accommodate themselves to conditions, but an equally disastrous result is the fact that business is at that very time attempting to discount some new change in the tariff which may take place in the future. From this, the following principle of customs duties may be deduced: such

taxes should not be changed oftener than is necessary, and changes when made should introduce the least uncertainty in industry.

This maxim should be applied with caution. Stability is of primary importance, but it does not excuse the retention of old taxes after their usefulness has ceased, nor does it justify bad taxes when better are proposed. Taxation, like every other science, is progressive, and evolution must not be impeded by blind respect for precedent.

3. Excise Taxes

The policy of the United States has long been to select for taxation a limited number of domestic articles of luxury or of minor necessity, as subjects of an excise tax, leaving the bulk of industry unprejudiced by any such petty restriction. At the end of the Napoleonic wars industry in continental Europe was practically at a standstill, on account of the onerous restrictions imposed by all varieties of excise taxes. Such an industrial depression was no doubt largely due to the effect of the wars themselves, and the expense necessarily involved in them, yet it seems certain that to a large extent the effect was heightened by the fact that the required taxes were imposed in such numerous and petty forms. At that time, the best financier was considered to be the one who could invent the most forms of taxation, and who could best ferret out industries hitherto untaxed.

In the United States practically the entire burden of internal taxes is borne by three articles of consumption which may be considered luxuries, viz.: spirits, tobacco, and malt liquors. The national income for 1912 was in full as follows:

Customs		$311,321,672
Internal Revenue—		
Spirits	$156,391,487	
Tobacco	70,590,141	
Fermented Liquors.	63,268,770	
Miscellaneous	31,361,792	
		321,612,190
Other Miscellaneous Items		58,844,603
		$691,778,465

Taxation of a few articles of luxury is undoubtedly the best form of excise taxation, and spirits, tobacco, and malt liquors seem to be most suitable for this purpose. These three types of luxuries are undoubtedly the best fitted

to bear a heavy tax without diminution of consumption, whereas an excise tax upon the necessities of life would work great hardship. Reformers have often advocated a prohibitive tax on liquors as a temperance measure, but it seems probable that the chief result of such a measure would be debasement of standard and encouragement of fraud. Excise taxes should not affect the article in its various stages of manufacture, but should be levied only when the article has lost its character of raw material, and is about to pass into consumption.

4 War Revenue

A discussion of federal taxation would be incomplete without some reference to the problem of raising revenue in times of war. It has already been stated that any system for the conduct of national affairs must be elastic, in order that temporary exigencies may be readily met. An example is found in the experience of the United States in the Spanish-American War.

At the outset there was about $25,000,000 available for its prosecution and the initial expenses of preparation were unexpectedly heavy. Steps were taken to provide requisite funds by the War Revenue Act approved June 13, 1898, which introduced the following changes in Federal finances:

First: A duty of ten cents per pound was imposed upon all importations of tea, which had formerly been admitted free.

Second: Excise taxes were raised to a considerable extent; rates of taxation upon certain articles, notably cigars, tobacco, and fermented spirits, were increased; the tax on manufactured tobacco and snuff was raised to twelve cents a pound, that on cigars was raised from $3 to $3.60 a thousand, and the tax on cigarettes was made proportionately higher. The tax on fermented spirits, beer, ale, porter, and the like was practically doubled.

Third: New taxes were levied on certain commercial transactions or on the paper certificates which evidenced them. Taxes were imposed on the issue of certificates of stocks and bonded indebtedness; on all sales of stocks, bonds, and other securities; on bank checks, bills of exchange, deeds conveying realty, custom house entries, insurance policies, leases, mortgages, and various tickets used by public service corporations.

Fourth: Taxes were imposed on certain occupations and on specified kinds of business enterprises. Annual taxes were levied on brokers,

bankers, and proprietors of theatres, bowlingalleys, billiard halls, or circuses. Taxes were also imposed on refiners of sugar and petroleum.

Fifth: Taxes were imposed upon legacies and distributive shares of personal property, in addition to similar taxes imposed by the various commonwealths. These taxes contained an exemption of $10,000 in the case of an inheritance to husband or wife, and were slightly progressive as the relationship became more distant, or as the amount exceeded the exempted minimum.

Sixth: Taxes were imposed on miscellaneous products such as mixed flour, medicinal and proprietary articles, perfumery and cosmetics, sparkling wines bottled, and chewing gum.

The entire addition to the receipts of the treasury from this Act was estimated at $148,481,306.

Besides the taxes above mentioned, the Act empowered the Secretary of the Treasury to borrow $400,000,000 for carrying on the war. These bonds bear interest at three per cent, are redeemable at the pleasure of the United States ten years after, and are payable twenty years after their issue. In addition, the Secretary of the Treasury was empowered to borrow an amount not in excess of $100,000,000 and issue therefor three per cent certificates of indebtedness maturing not later than one year after the date of issue.

5. State Taxation

The problem that confronts the state and its subdivisions in raising revenue is quite different from that of the federal government. Since the state is not exposed to international complications, elasticity of revenue is not so necessary to its system as to that of the nation. When a government is liable to be called upon at any time for extra funds for war purposes, there is need of a system so framed that it can quickly accommodate itself to changed demands. On the other hand, the state exercises certain legislative and administrative functions which vary little from year to year. The state legislature concerns itself with supervision of industrial organization within its borders and of the proper administration of its local units. It gives to towns and cities their forms of government and defines their powers; it stipulates the conditions under which charters of individual companies may be secured; it regulates the acquisition of wealth by its citizens and supervises such public institutions, educational and eleemosynary, as do not fall under local government. Municipal and

county governments, again, are primarily administrative in character. They provide for the maintenance of courts, police, highways, school systems, and other local services and enterprises.

From the settled distinction between state and local functions, certain types of taxes seem particularly adapted to each. As customs and excise duties appear peculiarly fitted to the national needs, so the poll tax, taxes on selected kinds of business, corporation taxes, i. e., taxes on forms of conducting business, inheritance taxes, and income taxes are supposed to be naturally adapted to the needs of the state. In both cases, as the wealth of the community increases, the returns from these taxes also expand, providing in a form that can readily be estimated for the increased social needs. If the yield is insufficient, resort may be had to the simple process of raising the rate of one or more of these taxes.

6. Division of Taxes

It is evident at the outset that those industries which are dependent upon the protection of the state should contribute to its support. Specific businesses whose money-making ability is made possible by the state, surely should be, taxed in order to maintain it. Corporations which owe their existence and powers to state franchises or charters, whose sphere of activity is enlarged or restricted by state control, and whose very opportunity to do business depends upon the will of the state, should in all justice be taxed for the benefit of the power which creates and fosters them, rather than for the benefit of the particular town or city which happens to be the situs of their business. If the success of the corporation is fostered by municipal or town concession, however, obviously some of its taxes should go to support that city or town, although the primary obligation may still be toward the state. Railroads and insurance companies are especially good examples of this type, since their activities within the state lines are perhaps most widely diffused. Turning from these legal monopolies to natural monopolies, such as mines, forests, and water supplies for power or irrigation, the case seems to be analogous. Although having local situs, their operation is state-wide in its scope, often affecting even interstate relations. Thus it seems natural and proper that such monopolies should pay their taxes to the state.

Questions of the application of inheritance and income taxes are more debatable. The wealth or income that is the subject of succession has as a rule been accumulated chiefly in some one particular locality, though

seldom entirely drawn from a single town or city. Every large enterprise is dependent upon the relations of its owner with consumers or correspondents throughout the state, as well as in other states. Therefore it seems just that such taxes should be applied to the benefit of the commonwealth.

7. Local Taxes

Applying the same principles to municipality, county, and town, we may conclude that those taxes which are raised from activities local in their character should be reserved for these smaller administrative units. In the country, real estate, on which so large a part of the community is dependent for its income and support, is the first object of taxation. In the township, agriculture is the principal occupation, and as in many cases it is the only industry, it must in some way be made to yield a revenue. Hence the general property tax has long been considered the proper means of securing the maximum local income. In spite of its cumulative disadvantages, the old New England township clings to it as the only practical source of revenue. The land and buildings of the farmer once represented his entire wealth and formed an easily ascertained basis for assessment. Individual wealth still comes in large measure from real estate within the town limits, and so is a natural subject of its taxes. If the townsman owns securities in addition to his real estate they too are subject to the general property tax, and theoretically will pay their share.

Turning to cities, the shortcomings of the general property tax become more obvious, because of the greater ease with which assets other than real estate can be concealed, yet the established custom is to rely upon this source for a large portion of municipal taxes. Furthermore, it becomes increasingly evident with the growth of cities that there are certain sources of wealth which arise from the activities of society as a whole, such as public franchises and other privileges connected with the land, and attempts are being made to secure to the local government a share in the benefit of these social enterprises. When valuable rights are granted by the community to water, gas, or street railway corporations, a considerable share of the profit of these industries accrues from the cooperation of society in the aggregate. The resulting rule is that while ordinary corporations are taxed mainly by the state, public service franchises are taxed by the municipality which grants them, and these furnish a convenient source of public income.

8. The Massachusetts System

As an illustration of the practical working of the general property tax, the tax system of Massachusetts is set forth in detail. A tax commissioner is appointed by the governor with the advice and consent of the council to hold office for three years, together with a deputy commissioner, three assistants, two permanent clerks, and three supervisors of assessors, all under the control of the tax commissioner, who supervises also the boards of assessors and collectors of taxes of the several cities and towns. Every three years the tax commissioner reports to the General Court an equalization and apportionment upon the cities and towns in proportion to the number of polls, and the amount of property. This apportionment is the basis upon which state and county taxes are levied, and warrants are sent by the treasurer and receiver general to the assessors of the cities and towns, who are elective officials not less than three nor more than seven in number. These assessors then add the share of state and county taxes to the amount of the taxes authorized by their local governments. This total tax is then collected by a tax collector who is also an elective official.

Thus it appears that Massachusetts raises a portion of the state taxes by direct assessment upon the property of the cities and towns in proportion to their inhabitants, and their amount of property. In addition, there are corporation and inheritance taxes which are payable to the state under direction of the tax commissioner. The general corporation tax is described in the chapter on "Corporation Taxes." Certain classes of corporations are subject also to special taxing, the rate varying in accordance with the nature of their business. That on life insurance companies, for example, is one-quarter of one per cent of the net value of all policies in force on the preceding December 31st, while that on savings banks is one-half of one per cent of the average amount of deposit for the preceding year.

Inheritance taxes are levied upon the succession of all property, tangible or intangible, a certain amount being exempt, and the rate varying in accordance with the closeness of relationship. In the case of a husband, wife, lineal descendant, or other person closely related, the estate is subject to a tax of one per cent if the value does not exceed $50,000, one and a half per cent if it exceeds fifty thousand and does not exceed one hundred thousand, and two per cent if its value exceeds one hundred thousand. Estates valued at less than ten thousand dollars are exempt. In the case of more distant relatives, the exemption is one thousand dollars; the estate is subject to a tax of three per cent if its value does not exceed twenty-five

thousand dollars; to a tax of four per cent if its value exceeds twenty-five thousand dollars and does not exceed one hundred thousand dollars, and to a tax of five per cent if its value exceeds one hundred thousand dollars. All other bequests or inheritances are subject to a tax of five per cent. The revenue for towns and cities consists of a poll tax, of two dollars, assessed upon every male inhabitant above the age of twenty years, whether a citizen or an alien, a tax upon all property, real and personal, situated within the commonwealth, and upon all personal property of the inhabitants wherever situated unless expressly exempted by law. Real estate for the purpose of taxation is construed to mean land and buildings. Personal estate includes goods, chattels, and moneyed effects wherever they are found, and ships and vessels at home or abroad; money interests; debts receivable in excess of debts owing, not including mortgage of real estate except in so far as the loan exceeds the assessed value of the real estate; public stocks and securities, with certain exemptions; and the income from annuities, together with professional incomes in excess of two thousand dollars a year.

CHAPTER VI
THE GENERAL PROPERTY TAX

The general property tax has for its nominal basis all the property, both real and personal, situated within the jurisdiction of the taxing power. In Massachusetts, for example, this comprises real estate land and buildings, machinery, merchandise, stock in process of manufacture, and other tangible property. It also includes money in hand, or in bank within or outside of the state, debts due from any source in excess of debts owed, bonds and stocks, and income from a profession, trade or employment in excess of $2,000 a year. Although the theory of the general property tax in the United States is as a rule founded upon the same idea, namely, that the general property of the citizen forms the most accurate basis for determining his ability to contribute toward the needs of the state, administrative details are so different that three general types of this tax may be distinguished.

1. Different Forms of the Tax

One of the oldest forms is what may be called the New England property tax, in effect in most territories north of the Ohio river and east of the Rocky Mountains. It depends primarily upon the local unit of government, and from that as a basis extends to the central taxing power. In this territory the significant unit of the taxing system is the township, which in the Western States is of the uniform six miles square, while in the older States it may even consist of a single city ward. Rarely does such a district contain over 5,000 inhabitants, and the number is generally less. Assessors are appointed for a short period from among the citizens, and have considerable personal knowledge of the affairs of their fellow townsmen. With the aid of this knowledge they apportion the tax required for town, county and state purposes among the members of the community. This type of taxation is the most democratic: it is administered in the first instance by men appointed from among the taxpayers, who are able to judge of their work and are in a position to remove them if it is unsatisfactory. Variations of this method result from a greater control by central authority, until in particular states there is such control by the central government through tax commissioners that the authority of the town can no longer be considered primary.

What may be called the southern type has so advanced until the town yields to the county as the original unit. Here the assessors are no longer so well acquainted with the individual affairs of the citizens within their district, and the personal declarations given, with penalties attached, are of more importance. The machinery of government is called upon to exert a more effective supervision over the raising of revenue and the sheriff and county courts have intimate relations with the tax system.

This supervision increases as we go farther west, and the Pacific coast type differs from the southern type chiefly in spirit and effectiveness. However, while the local unit may here still be considered the unit of authority, the state really assumes supremacy and authority flows from it to its subdivisions. The county assessor elected for a period usually of four years, assisted by many deputies, has charge of the collecting of taxes, and these officers constitute a county board of equalization between individuals. In the other forms of assessment, the only officials having power to change rates as between individuals are local officers. In the last form of administration, local officers have comparatively little authority, the county commissioners dealing directly with the individuals in their districts.

2. Changes in the Tax

Historically the general property tax was at first entirely personal and local in character. It was especially adapted to the needs of the New England towns, where the state tax was a comparatively small item in the budget, and where the chief expenditures were voted upon directly in the town meeting. Neighbors were acquainted with each others' affairs, and the ability of each was well represented by his total belongings. Property is the criterion of ability, an assumption that in early days was fairly correct. Recently the financial ability of individuals has come to be measured by a different gauge, and productive power is rapidly taking the place of possessions. Formerly the capital of the New England farmer was as a rule invested in the land itself, and if he was so fortunate as to have a surplus in stocks and bonds, this simply represented ability to bear additional taxes. At the -present time there are many persons earning large salaries, whether for work or for superintendence, who possess little above their income, yet who live more expensively and comfortably than does the man who may at any given period have a larger amount of assets permanently invested in land or securities. Nowadays, ability is measured not so much by stored up

property as by the amount of income which annually flows through its owner's hands.

Parallel to this change of base from possessions to productiveness has been the change in its personal and local nature. Formerly taxes were levied upon individuals, and the personal character of the imposition was maintained. The present tendency is to leave the owner out of consideration, and to tax the property itself as such. Witness the fact that taxes on real estate are sometimes assessed to "owner unknown," and taxes on bank shares are now taxable at the bank, instead of at the situs of the holder. This is a departure from the doctrine that personalty follows the owner and that personal property should be taxed at the situs of the owner. The reason for the change is no doubt the greater convenience of levying and collecting at the source, but it none the less shows a change in the character of the tax. Again, while generally advocated on account of its local advantages, the general property tax has come to be a means of revenue for state and county as well. State revenues are supplemented by the simple expedient of adding a percentage to the local general property tax.

3. Theoretical Aspects of the Tax

Tested by the canons of taxation, certain noteworthy defects are at once apparent in a tax system which depends to so large an extent upon the general property tax. If the general property tax were ever justifiable upon the ground of equality, that time has long since passed; the hoarded wealth of the individual is no longer an index of his financial status in the community. Again, the apportionment of the state and county tax among the several towns gives rise to injustice, because the valuations of one town seldom bear the same relation to actual cash values as that of another. Assessors are tempted to keep down the valuations of their own communities, hoping thereby to reduce their proportion of the state tax. The time, the manner, and the amount of the tax to be paid by the individual are clearly defined, but in the broader aspects of the canon of certainty, universality is utterly lacking in the administration of this tax. A premium is put upon dishonesty and inevitable "tax dodging," so that it has been justly said that personal property taxes are paid only by the estates of widows, orphans, idiots, and lunatics. The requirements of the canon of convenience are fairly met by general property taxes, since they are levied at the same time every year, generally in April or in May, so that the

taxpayer may reasonably anticipate the season and the amount of his taxes. If taxes are assessed in the fall, crops are usually exempted in recognition of the justice of lightening the burden of the farmer. Concerning the canon of productivity, so far as cheapness of collection is concerned the general property tax yields a larger return on the amount assessed than almost any other tax, although an unfavorable effect is the diversion of capital from industrial channels to investment in tax exempt securities.

The chief weakness of the general property tax lies in its tremendous incentive to dishonesty. It takes a remarkably sensitive conscience to confess ownership of stocks and bonds, from the annual income of which the tax would subtract from twenty-five to forty per cent. If the taxpayers of today should disclose and pay this tax it would fall at once as a burden upon the next borrower, for no one would voluntarily pay a third of his entire income from investment in the shape of taxes. It is conceded that resort to 66 double taxation" must not be had until all other expedients have failed, yet this evil invariably inheres in the general property tax if maximum efficiency is to be secured. Taxation of mortgages and other deeds offers an illustration. If the mortgage is assessed both to mortgagee and to mortgagor it is double taxation, pure and simple. If to the mortgagor only, he pays an amount proportionately greater than his actual possessions; if to the mortgagee, he shifts the tax to the mortgagor, and the same result occurs. Either way the result is unsatisfactory. Lastly, the tax falls heaviest upon farmers, who as a class are benefited the least by governmental expenditure, and are least able to bear the tax. The farmer's means are generally visible and hence easily assessable; besides his full proportion he pays a part of the share of those whose wealth is concealed in safety deposit vaults.

4. The Practical Working of the Tax

The general property tax presupposes that the amount of general property can be ascertained, but experience does not bear out this assumption. For instance, in 1890 the United States census estimated the true value of real estate in this country at $39,544,544,333, of which all but $3,833,335,225 was legally subject to taxation. The assessed valuation of this $35,711,209,108 taxable realty was $18,956,556,675, something over fifty per cent of its estimated true value. Personal property was estimated at $25,492,546,864, of which only $6,506,616,743, or about twenty-five per cent, was actually assessed. In 1900, the figures had changed so that 44.4

per cent of the taxable real property and only 22 per cent of the taxable personal property was actually taxed. In 1904, the relation had again changed so that 48 per cent of the taxable real property and only 19.8 per cent of the taxable personal property was included. This is a striking comment on the hypothesis that general property is ascertainable.

The statistics of the general property tax show that the share of the tax paid by personal property, in relation to that paid by real property, is steadily decreasing. Reasons for this are not far to seek. Returns required by law are generally not made, and if they are made, no valuation necessarily results, since taxpayers when under oath are notoriously pessimistic as to the solvency of their debtors. Fictitious debts are often incurred, and this by business men who are otherwise extremely honest in their dealings. Assessors connive at the evasion of this tax: stock in trade is often tacitly exempted and personalty either is not found, or is undervalued, in order that new business may be attracted.

The Tax Commissioner of Massachusetts hardly exaggerates when in his report for 1911 he states that the people do not want the law in regard to the taxation of personal property enforced. Conditions have greatly changed since its inauguration and it has outgrown both its usefulness and its popularity. Since this is so, attempts to assess all taxable property must fail to a large extent, and the only alternative seems to be a change of the system itself. In the words of the Governor of Wisconsin, quoted from an address before the Conference of Governors held at Richmond in December, 1912:

> The old method of trying to raise revenue by taxation of intangible personal property has completely failed. Instead of adequate revenue justly obtained, the result almost uniformly has been inequality, discrimination, evasion, and, so far as this source goes, increasing deficiency.

CHAPTER VII
THE INCOME TAX

THE growing popularity of an income tax rests upon the idea that incomes are the best criterion of the ability of the taxpayer. The income tax is the culmination of various attempts to secure equality in the tax burden. The earliest taxes were levied merely in accordance with numbers; next property formed the basis, and as this proved inadequate various departures were suggested. Taxes upon expenditures were tried, and later product was held to be the best test of faculty. As a further improvement, a tax on incomes was proposed. This plan was popular in the United States from 1840 to 1860, and since 1890 its advocacy has revived with increasing vitality.

1. Difficulties with the Tax

The chief difficulties with the income tax are administrative. Most economists who hold to the faculty theory recognize the intrinsic justice of payment of taxes based on income, but several obstacles to the operation of such a system stand in the way of its adoption. In the first place what is meant by income? Is it gross income or net income, money income or income in kind; should all incomes be taxed, or should a distinction be made between earned and unearned incomes? To the first of these questions the prevalent opinion is to the effect that only net income should be taxed. Expenses of production must be taken out before any real income capable of supporting the tax burden can be found. While this proposition is obvious enough, it is not entirely adequate. If expenses of production be subtracted, should not living expenses also be deducted before the tax is imposed? They constitute as real an item in the power of production in the industrial unit as do the expenses of the processes of manufacture or agriculture themselves. An attempt has been made to eliminate this factor by differentiation and graduation of income, but the matter has by no means been finally set at rest. The question at the outset is, can all incomes be ascertained for taxation, or is it possible only to determine the money income which the taxpayer receives ? Obviously the latter. Hence to insure reasonable certainty of collection the tax must be restricted to money incomes. Again, is the social justice, which it is the particular aim of the income tax to secure, best attained by taxing all incomes alike, or should a distinction be made between the income of the holder of inherited bonds,

who does no harder work than to cut his coupons, and the income of the working man who uses his whole time to secure a competency for himself and family? These and like problems cannot be eliminated from the administration of income taxes.

A few attempts have been made to differentiate incomes in accordance with their source. Notwithstanding that the income from inherited property differs in tax-paying ability from that accruing to industrial efforts, yet it has not been found practicable to establish this distinction. The industrious man may invest his surplus in the same securities as those from which the drone derives his livelihood. In the one case this represents a wise provision for dependent members of the family; in the other it represents merely a source of unearned income. Government can go no further than to make distinctions between salaried incomes, profits, and dividends. But this must be unsatisfactory, since incomes of the same class may represent totally different types of industrial returns. Furthermore, a satisfactory application of the income tax cannot be attained without intolerable inquisition, involving a hitherto unknown integrity of public officials. So the Gordian knot is cut by refusing to go behind the general nature of the source of income.

2 Graduation of the Tax

It has been found better to attempt equalization between the burden of the poor and of the rich by means of graduation rather than by differentiation of the income tax. Graduation implies an advance of the rate as the size of the income increases. Modern graduated taxes may be either progressive, when the rate increases indefinitely with the amount of income, or degressive, when the rate progresses up to a certain point and afterwards remains proportional. Progressive taxation is sometimes favored because its adjustment seems most consistent with the faculty theory, which holds that an income of ten thousand dollars can better bear a tax of ten per cent than can one of a thousand, while an income of one hundred thousand dollars can bear it better than either. On the other hand advocates of degressive taxation assert that after a certain point the inducement to saving is lessened and that care should be taken not to discourage the growth of industrial enterprise to natural proportions, however large. Probably the soundest tax is degressive, with a high limit before progression ceases.

Another feature to be considered is the exemption of a minimum income. This minimum is generally set at one thousand dollars or thereabouts. It is favored on the ground that the smaller the income the more heavily it is affected by the tax, and that a certain living wage should be allowed to go free of any tax. This is in line with the English experience that the classes most heavily affected by the tax are those whose income is just above the exempted amount. Two grounds of objection are raised to exemption of any sort. The first, an economic one, and of little weight, urges that the individual owes a return to the state for protection of life and liberty, and that the tax paid to the sovereign should be included in living expenses. The second, political, holds that exemption is dangerous, especially in a democracy, since the appropriation of the proceeds of taxation would be subject to the voting control of non-taxpayers. This contention carries some weight, but it does not appear that in this country the exempted classes have conspired toward any noticeable increase in lavish public expenditure. On the whole the graduated tax together with a minimum exemption seem to offer the best type of income tax.

3. Federal Income Taxes

Upon the statutes book of the Federal Government of the United States are to be found three income tax laws. The operation of the first, which had its origin in the necessity for revenue caused by the Civil War, covered a period from 1861 to 1872. Under it a tax of three per cent was levied upon all incomes from whatever source exceeding $800, except that upon any income derived from United States securities the rate was one and a half per cent. This tax was entirely proportional. In 1862 however, the exemption was reduced from $800 to $600, and the rate was made slightly progressive, incomes above $600 and below $10,000 paying three per cent on the excess of the exempted amount, and those above $10,000 paying five per cent. These rates remained in force for two years when the pressure of the demand for revenue resulted in the comprehensive measure of June 30, 1864, by which the duties were increased and rates made more strongly progressive. Under this act, incomes between $600 and $5,000 were taxed at a rate of five per cent; those over $5,000 to $10,000 at seven and a half per cent, and all above $10,000 paid a uniform rate of ten per cent. From this time until 1872 various modifications in rates and exemptions were made, the highest rate in force at one time being ten per cent, the lowest two and a half per cent, while exemptions varied from

$600 to $2,000. The highest yield from the tax in any year was $72,982,159, in 1866. In 1872 the law expired by limitation, and as the war debt had been permanently adjusted, no effort was made to revive the tax until 1894. In that year, in order to forestall deficiency in revenue caused by a downward revision of the tariff, another federal income tax law, modeled upon the later war legislation, was passed. All persons having an income in excess of $3,500 were required to make a verified return to the collector as were all persons acting in a fiduciary capacity. A minimum exemption of $4,000 was allowed, and the feature of stoppage at source taxation of wealth while still in the hands of its original producer was given more prominence. Sworn statements were treated as confidential, but penalties were imposed for false and insufficient returns. The constitutionality of the law was attacked before it went into operation, and the adverse decision of the Supreme Court prevented its taking effect. Some features of this decision stand out upon the record in bold relief. On the first hearing the court held that a tax imposed upon the income of real estate was unconstitutional because it was a direct tax within the meaning of the Constitution, and should have been levied by the rule of apportionment required by Article I, Sec. II: "Representatives and direct taxes shall be apportioned among the several states which may be included within this Union according to their respective numbers." The court also decided that the tax was invalid in so far as it related to income from state or municipal bonds, since the National Government cannot tax the power of the state or local government to borrow money. At the second hearing, and this time before the full bench, the whole act was declared unconstitutional, since a tax on the income from personal property is direct, as well as a tax on the income from real property. This practically amounted to a decision that any income tax is unconstitutional. The ruling of the court was not acceptable and seems to have been in contravention of dicta set forth in earlier decisions. The question can never arise again, however, as the required number of states have already ratified the constitutional amendment of July 1909, authorizing federal income taxes.

The income tax provisions that form a part of the tariff act recently passed by the Sixty-third Congress contain many of the principles incorporated in its predecessors and introduce several new ideas not yet worked out in practice. The Act provides for a tax of one per cent on the entire net income of every person from all sources. A deduction of $3,000 is allowed in each case, and an additional deduction of $1,000 in the case

of a married person living with wife or husband. That is, incomes are taxed only on the excess above $3,000 for single persons, and $4,000 for married persons. In addition to the basal rate of one per cent on all incomes, higher percentages are assessed on larger incomes, as follows: An additional one per cent on the excess of incomes over $20,000 up to $50,000; two per cent for $50,000 to $75,000; three per cent for $75,000 to $100,000; four per cent for $100,000 to $250,000; five per cent for $250,000 to $500,000. In estimating the amount of income, deductions are to be made for necessary expenses of carrying on business, interest on insurance, all taxes, losses by fire, storms, shipwreck not covered by insurance, worthless debts, allowance for wear and tear of property, dividends on corporations taxed on their incomes. In the case of corporations, the income is taxed at the source, and is exempted in the hands of the shareholder. The following classes of organizations are exempt from taxation under the Act: Labor, agricultural, or horticultural organizations, mutual savings banks, fraternal societies, cemetery companies, building loan associations, religious, charitable, scientific, and educational corporations, business leagues, chambers of commerce, civic leagues, organizations for social welfare, mutual fire and marine insurance companies on the amount of return premiums to policy holders.

4. State Income Taxes

At the present time only eight states rely, to an appreciable extent, upon the income tax. These are Massachusetts, Mississippi, Nebraska, North and South Carolina, Oklahoma, Virginia, and Wisconsin, and their taxes represent in some measure the survival of the colonial faculty tax. In Wisconsin alone have modern theories been put into effect. Of these states only Virginia gets an appreciable part of her income from the income tax. Out of a total state revenue of about two millions, this tax has yielded not far from one hundred thousand, reaching the maximum of $122,047 in 1908.

Since Virginia has, next to Wisconsin, raised the largest revenue from this source, it is evident that the effectiveness of the tax is practically nil. Generally the assessment is by local officials upon statements made by the taxpayer, and in many cases no attempt is made to collect any revenue from the source. Probably the true reason for the failure is due to the administration of the laws. Often they have lacked provision for their own enforcement, so that officials have permitted false or evasive returns.

Some incomes by their nature have been difficult to reach. As a consequence, the new statute in Wisconsin offers a welcome example of what is possible under efficient administration. The complete failure of the old way of trying to raise revenue from intangible personalty led to constitutional changes opening the door to the income tax; certain classes of personal property were exempted, and a tax on the income of individuals and corporations was substituted. This new tax amounts to a graduated tax upon net income, the first thousand dollars of a large income paying a lower rate than the other units. The income tax assessors have been appointed by the Wisconsin Tax Commission, under civil service and accountable to the commission. These assessors value and assess the taxable incomes of individuals, while the Tax Commission itself assesses the incomes of corporations. In the opinion of the commission nearly ninety per cent of the individuals subject to taxation under the law were individually taxed in the first year of its operation in 1912. In the preceding year of the personal property tax, the yield was about $1,500,000, while the proceeds of the income tax in its first year were over $3,500,000. Two years is hardly time for a complete test, but Wisconsin has at least proved in her own case that a larger revenue can thus be obtained from personalty than from general property, and the actual result has been in some localities to lower the rate of taxation.

5. English Income Tax

The discussion would be incomplete without reference to the British system which is the pioneer forerunner in this field of taxation. Originally imposed in 1799 as a war tax it was temporarily repealed in 1802 on the prospect of peace, but was reimposed the next year in a form much like the present, and was continued during the period of the Napoleonic wars. In 1816, after the final peace, the income tax was repealed, and not reimposed until 1842. At that time in view of alarming annual deficits, the income tax was revived for a period of three years, with the understanding that it was to be abolished when the necessity had passed, but it was continued from time to time for short periods, and in 1853 it was enacted for a provisional period of seven years. Since that time, notwithstanding its theoretical limitation, it has always formed a substantial item in the English budget. Under this English law no attempt is made to levy upon a lump income, but incomes are rated under four schedules, viz: from rentals; from stocks and bonds; from salaries and pensions; and from other kinds of revenue.

Levy of the tax is made so far as possible at the source, and personal statements are required only when exemptions are asked.

Up to 2,000 at present the rate is 3.75 per cent, while incomes below 160 are exempt. On incomes between 2,000 and 5,000 the rate is 5 per cent. Graduated exemptions are allowed incomes over 160, decreasing as the income rises, until there is no exemption for an income of 750 or over.

6. Conclusion

It is evident that the income tax is coming in on a wave of popularity which has not yet reached its height. The reason for this is not far to seek; it is happily stated in the report of Commissioner Trefry, of Massachusetts, for 1911: "Taxation ought, to a very great extent, to require from citizens equality of sacrifice for the support of government. Taxation based upon the capital value in the case of money, credits, and securities, does not require the same quantity of sacrifice as in the case of similar taxation of real estate. Equality of sacrifice will be more nearly secured by taxation based upon the product of property rather than upon its principal value. Herein is the fundamental soundness of income taxation that it requires payment to government in proportion as the citizen receives that with which to pay. It does not follow, of course, that we can frame all our tax laws on an income basis." The average citizen, as well as the scholar, is perfectly aware that present tax systems do not accommodate themselves to the needs of the people. A remedy must be sought for the abuses of the old property tax and opinion is turning to the income tax as one of the best practical substitutes.

This tendency is illustrated by the recent enactment of a federal income tax law, and its acceptability is witnessed by the readiness with which the requisite three-fourths of the states approved the constitutional amendment necessary to its adoption. It is yet too early to forecast the results which will come from this new departure in the field of national finance, but much is to be hoped from it. It contains many of the features which the most advanced tax reformers advocate as essential to a proper income tax. It is moderately progressive; it taxes at the source; it regulates exemptions according to the size of the family. These are desirable attributes of any tax, and it is well that they should be incorporated in any federal income tax. The operation of this tax will be watched with keen interest by students of taxation.

The adoption of the income tax as part of the revenue system of the federal government raises the question as to the future status of this tax in the revenue systems of the different states. In the past the sources of revenue of the federal and state governments have been kept strictly separate. It seems unlikely that this policy of separating the sources of revenue of nation and states will be abandoned in the future. It is, therefore, probable that the definite adoption of the income tax by the federal government will lead to the gradual abandonment of this tax by the individual states.

CHAPTER
INHERITANCE TAXES

THE inheritance tax, as its name implies, is a tax on the transfer of property from one generation to another, or, as the law calls it, a tax on successions. The idea is simple, but the administration involves serious problems of social justice. Inasmuch as the right of succession itself is the creation of law and the transfer is promoted and guaranteed by the state, it seems reasonable that in case of a legacy to a stranger, or to one of distant kin, a part of that legacy should, in the process, go to the state as a tax. Once granted that the state has a legal and moral right to restrict inheritances, the justice of this tax is apparent. In the case, however, of bequests to the immediate family, the justice of the tax is not so patent because of the dependent relation of direct heirs. It is often the case that the death of the father of the family tends toward straitened circumstances, since the increase of wealth to which the family acquires title by no means makes good the loss of the chief wage earner. Accordingly, most states make liberal exemption of amounts which go to the widow of the deceased or to lineal descendants.

1. The Question of Exemptions

The statute generally recognizes two classes of exemptions: one of small estates and one of direct heirs. Most states allow small exemptions regardless of the ties of kin. Exemptions in respect to collateral inheritances are of small account, but where the immediate family is concerned, they are of primary importance. Here come in all the questions of the dependence of the family upon its head, and, while some members of the family frequently have an independent source of income, it appears to be pretty well settled that the new accession of wealth does not, as a rule, augment the family income. For this reason the states usually grant a substantial exemption, often as large as $10,000. This seems to obviate the charge of hardship often made against the inheritance tax, especially since exemptions are usually reckoned on the amount of the individual legacy, and not on the total value of the probated estate.

2. Progression

Analogous to the problem of exemption is that of progression, which implies that the tax rate increases with the size of the legacy. Progression, if applied at all, is slight in the case of direct inheritances, while for

strangers to the blood it may involve a considerable increase in rates. Some of the states have pushed the principle of progression of taxes on indirect inheritances so far that a smaller legacy sometimes nets more than a larger one. For instance, in Oklahoma the tax amounts to one hundred per cent upon legacies in excess of $95,600 to all persons other than those closely akin. In general, however, the tax is seldom more than fifteen or twenty per cent, regardless of the amount, although in New York the maximum rate is twenty-five per cent on all inheritances of $1,000,000 or over. While a confiscatory rate can hardly be defended, a fifteen or twenty per cent maximum seems open to little objection. Such bequests, after all, represent a fortuitous or privileged accretion of wealth, and the recipient is amply able to bear the heavier tax. Progression, if not too extreme, seems to accord with the taxation by ability theory.

3. Justification of the Tax

The chief arguments in favor of an inheritance tax are: (a) the right of the state to curtail bequests, (b) the wisdom of curbing the perpetuation of large estates, and (c) the advantages involved in incidence and collection.

(a) The right of curtailment is a matter of historical and legal development. It goes back to the time when such a thing as inheritance was unknown and came about only as a gradual concession from the sovereign; and it seems proper that the state should receive compensation for the favor.

(b) The argument for the check on large fortunes is forced to the front by the new ways of looking at social problems, and the popular outcry against the oligarchy of wealth finds some justification, in times when vast power is attained by the simple possession of money. There is, to be sure, a flavor of inconsistency in this doctrine, since the demand for a greater diffusion of wealth is directed primarily against tying up funds in the hands of one family, while in practice it is only collateral inheritances which pay a large tax. The legitimate conclusion of this argument would seem to demand that the rate of taxation on direct inheritances of large sums be increased more sharply than is countenanced at present. There is, nevertheless, merit in the idea.

(c) The administrative advantages of the tax are obvious, and although the canon of elasticity is not fully satisfied, the other canons of taxation are met almost absolutely. The tax is certain, the cost of collection is slight, and it surely falls at the time most convenient for the bearer. The tax

cannot be shifted, and fraud is nearly impossible. The difficulty of evading this tax was well shown in the case of the administration of the estate of the late Jay Gould, over twenty years ago, when the inheritance tax was in its infancy. During the lifetime of its owner this fortune was assessed at only half a million dollars, while at his death it paid an inheritance tax on approximately one hundred and forty times that amount.

Among the minor arguments, we may advert incidentally to the curious theory that inasmuch as the testator may be presumed to have dodged his taxes for a series of years, a tax on successions best fits the crime. Louisiana in fact has gone so far as to pass a law that on proof of payment by the deceased of the full amount of his taxes for the last five years prior to his death, no tax shall be levied. The accidental income argument has already been mentioned and seems to be valid in many cases. The legatee cannot count on any substantial increase in his fortune from the testator and often has done nothing to deserve it; he is surely in a position to concede a part of this increment to the state. Again, it is ingeniously urged that the state is a co-heir with the individual, for governmental activities have made the accretion of the fortune possible. There is thus a kind of partnership between the individual and the state, and the surviving partner should secure its share when the partnership is wound up.

4 The Tax in Operation

Experience indicates that inheritance taxes are peculiarly suited to state purposes. Inheritance taxes were collected under Federal authority as war measures from 1862 to 1872, and again from 1897 to 1902. State governments, however, have better machinery for the levy and collection of these taxes in connection with the probating of will and proceedings in intestacy. Furthermore, the wealth taxed has, perhaps, been aided by the state rather than by Federal government. At the present time only ten states are without inheritance taxes, though many of the laws are quite recent, nineteen of the states having passed such legislation in 1909-10. Since 1890, a general overhauling of inheritance taxes has resulted in greater efficiency. In recent years taxes are more sharply progressive, rates are generally higher, exemptions lower, and the operation of the laws has been extended from personal property to realty.

Discussion of the various provisions of the tax laws may be facilitated if the system in one state is given as an example. That of California has been chosen, and is reproduced in tabular form.

Classification or Indication of Relationship	Property Exemption	Application of Rates to Value of Inheritance or Bequests				
		On Excess after Deduction of Exemption from $25,000.	$25,000 to $50,000	$50,000 to $100,000	$100,000 to $500,000	In Excess of $500,000
Husband, wife, lineal issue, lineal ancestor, adopted or mutually acknowledged child..	Widow or minor child, $10,000 Others $4,000	1%	1½%	2%	2½%	3%
Brother, sister or descendant of either, wife or widow of a son, husband of a daughter.....	$2,000	1½%	2¼%	3%	3¾%	4½%
Uncle, aunt, or descendant of either	$1,500	3%	4½%	6%	7½%	9%
Grand uncle, grand aunt or descendant of either	$1,000	4%	6%	8%	10%	12%
Other degree of collateral consanguinity, stranger in blood, body politic, or corporate....	$500	5%	7½%	10%	12½%	15%

The California schedule has been chosen not only because it contains representative exemptions and rates, but because heirs are divided into several classes. This last factor has been productive of discussion both by economists and practical experts. On the whole, it seems that while three classes at least should be provided for, more are superfluous. There are certain persons, such as wife or child, who are practically dependent upon the work of the head of the family, and it needs little proof to show them entitled to large consideration. Then, there are other persons who are not entirely dependent upon the testator, but are bound to him by ties of consanguinity, which demand consideration at the hands of the lawmakers. Finally, there are other persons remote in relationship to whom the legacy is strictly an incidental increase in wealth. Whether more classes than these should be included, and whether distinction should be made between cousins and second cousins may well be doubted. Many of the states have

refused to provide for more than three classes, and that seems to be a sound policy.

5. Differences in State Laws

It is unprofitable to analyze the difference between particular state laws. They vary greatly both as to amount of exemption, classes favored, and rates of progression. In all cases attempts have been made to secure social justice with a maximum return to the state. One difference in state laws, however, which has been a source of much confusion, needs to be stated. It relates to the taxation of the property of non-residents, especially shares of stock and other intangible property. Fourteen states tax the stock of corporations organized under their state laws, if owned by non-residents, when the certificates are kept outside the state. Eight more tax such shares regardless of the place ' where the certificate is taxed, and four other states seem to be authorized to do so under their statutes. The mere situs of the stock certificate is justification for inheritance taxation in some states.

Variation in the laws makes possible the following travesty of the science of taxation, let it be supposed that a man lives in one state, has stock in a corporation organized in another state, but doing all its business in a third state, while he keeps his stock in a safe deposit box in a fourth state. This property may be obliged to pay the full inheritance tax four times. The first state might be any one of thirty-eight, the second of twenty-four, the third of nine, and the fourth of six at least. If all these taxes are collected in full it needs little proof to show that the collateral inheritances will not represent a large accretion of wealth to the legatees.

In order to obviate this difficulty, together with other of like nature, a movement for a uniform inheritance tax law has been started in recently held National Tax Conferences. At the first conference, in 1907, it was resolved that " successional inheritance tax laws should be so amended that the same property should not be taxed by more than one jurisdiction at the death of the owner," and in the following year a committee was appointed to draw up a model bill which should accomplish this result. In 1910, at the fourth National Tax Conference held at Milwaukee, the report of this committee was submitted. The bill so originated proposes a reasonable tax definitely fixed and easily computed, which would provide for fair revenue. It is graded as to relationship and progressive as to the amount of inheritance, with each inheritance as the basis of computation. 'It recommends the avoidance of double taxation of securities by taxation at

the residence of the owner alone. The proposed law provides that residents of a state shall pay an inheritance tax on all intangible property, and on all tangible property situated within the state, while non-residents may be required to pay inheritance taxes only on tangible property within the state. The conference recommended the adoption of the bill by concerted action of all the states.

CHAPTER IX
CORPORATION TAXES

THE increasingly popular corporation tax is one of the outgrowths of the defects in the general property tax. As modern business tends more and more to take on the corporate form, the extensive ownership of stocks and bonds makes assessment under the old general property tax impracticable. The intangible nature of investment securities impedes discovery of their whereabouts, or indeed of their value, except when they are listed on the stock exchange. Under the general property tax, it is hardly just to assess all value in the hands of the corporation, and it cannot be done in the hands of the stockholders. Accordingly, attempts are now made in almost all of the states to impose upon corporations a special tax to be collected "at the source," thus avoiding taxation of the same property a second time in the hands of the shareholders. To effect this, a rigid supervision is necessary, such for instance, as is the practice in Massachusetts, where the work of tax commissioner is supplemented by that of the commissioner of corporations.

1. Different Classes of Corporations

The necessity for state supervision may vary with different classes of corporations. In speaking of corporations, careful distinction is needed in the use of terms. What we speak of as public service corporations constitute the principal class. There can be no doubt of the right and duty of the state to exercise a control over such enterprises which properly includes inquisition into their affairs for the purpose of taxation. Railroads present, perhaps, the best example of this class of corporate enterprise, and in fact the states as well as the Federal Government are inquiring every year more closely into the way in which the business is conducted. Next in line come telegraph and telephone companies, followed by all other agencies of communication and intermunicipal traffic. Whether city street car companies should be controlled to such an extent by the state, or whether their regulation and taxation should be left entirely to the local governments has already been discussed in the chapter on Federal, State, and Local Taxation, and the question need not be raised again. Other types of quasi-public corporations which belong here are water, gas, and electric light companies, the public nature of whose services is beyond dispute.

On the border line between quasi-public corporations proper and other corporate enterprises, are banks, trust and insurance companies. While it is an established rule in the United States that such services shall not be rendered by the government itself, the corporations that render them stand in such a fiduciary relation to their depositors and clients, that the state owes its citizens the highest protection against misuse of their powers. This of itself gives the state a right to inspect the affairs of such businesses, and it is but a step farther to apply to them the principle of taxation at the source. No complaint can reasonably be made, if the deposits, funds, and policies are taxed in the office itself, so long as the proceeds are not taxed again in the hands of the beneficiaries.

Natural monopolies, such as mines and forests, represent the typical third class of corporations subject to state control; here regulation is proper, but has not as yet everywhere been recognized as necessary. It is becoming increasingly evident that these natural advantages are of supreme importance to the commonwealth as a whole, and that their benefits are not confined to the localities in which they happen to be situated. It is, of course, debatable how far state interference is justifiable, so long as there is no misuse of the property, but the tendency of public opinion at present is to make them more and more conformable to extended state control. When the advisability of state regulation is once conceded, it is not then difficult to maintain the proposition that the principle of taxation at the source should be applied here as well as in the other cases. This seems to be more and more the view of state legislators, and states are gradually coming to recognize these industries as a fitting field for corporation taxes.

So far we have dealt with corporations whose public nature is more or less evident. What shall be done with those enterprises that are essentially private in character which have assumed the corporate form as a measure of convenience? In view of prevalent discussion of the advisability of governmental control of monopolies, little controversy will be excited by the statement that when private industries tend to become monopolistic, state interference and its corollary, state taxation, are called for. The gigantic industrial combination, regardless of the articles in which it deals, becomes of vital importance to the entire community, as soon as its monopolistic character is attained. Corporate taxation in such cases is nothing more than self protection, and the right of the state to interfere will not long be questioned.

When the business is almost a private business, and the shares of stock are retained in the hands of a few families, although the outward form is that of a corporation, the economic nature of the enterprise differs little from that of a partnership. The question whether incorporation as a measure of convenience justifies the application of the rules of taxation commendable in the case of public service corporations is debatable. The argument in favor of state taxation rests largely upon the idea that taxation at the source is best wherever it can be applied, and that, inasmuch as the corporate form assumed makes it possible here, it should by all means be employed. There is much to be said for this contention, yet it does not state the whole case. Taxation should have its basis in sound economics, and where there is no economic distinction between a corporation and a partnership, if other things are equal, the two should be taxed in the same manner. It may be said that it would be advisable to tax the earnings of partnerships at the source, and that, inasmuch as taxation at the source can be employed with these corporate partnerships, a step in advance is taken when it is instituted. Even if this point of view be right, however, it seems that for purposes of taxation the corporate partnership should be classed rather with other partnerships, than with quasi public corporations.

2. Basis of Assessment

Justice in the taxation of corporations is ultimately much the same as in the case of individuals, though the particular items taxed vary in accordance with the nature of the business. In the final analysis, taxation must rest on ability. Bearing this in mind, let us inquire whether the basis of corporate taxation should be property, the volume of business transacted, or earnings? The answers given by the states differ to a considerable degree, but it seems possible to draw a theoretically correct conclusion.

Considering first the question of property as the basis of taxation, we come back to the old objection to the general property tax. Property is no longer the gauge of ability to support the state, and it should not form the basis of taxation, if other sources are available. Even if this point is not conceded, we find an additional difficulty in the nature of the property of corporations. Should the cost of the property, its physical valuation, or the stocks and bonds be taken as the measure of its assets? The cost of property can rarely be ascertained, and in no case represents the true value at any given time. If the physical value of the property is assessed as of any one year, this difficulty is apparently removed, but in addition to the

physical value there is a franchise value, which would thus entirely escape taxation. Again, if we take the par value of the stocks and bonds outstanding, it is notorious that par value bears little or no relation to actual value. The valuation of stocks and bonds at market rates also leads to difficulty, because many of the outstanding shares have a fictitious market value created solely for purposes of speculation, and as a matter of fact only slightly over fifty per cent of them pay dividends. Finally, taxation of bonds at market value is open to the strong objection that bonds represent indebtedness rather than assets, although, of course, they are assets in the hands of their holders, whose income is thus taxed at the source. On the whole, the practical difficulties involved in forming a just estimate of the property are tremendous.

3. Tax on Corporate Earnings

In view of these shortcomings of the tax on corporate property, there seems to be little doubt that some kind of a tax on corporate earnings is preferable. Here the same problems again rise which are involved in the taxation of incomes of individuals, with certain added difficulties growing out of the fact that the distinction between gross and net earnings is more important and also more difficult to determine. In the first place, taxation of earnings based on the volume of business may be discarded, as one example suffices to show. A railroad carrying heavy loads of coal and ore may have a larger ton mileage than another line doing an express business, but the second road in proportion to its ton mileage earns a vastly greater profit from each ton carried. Conceding that actual earnings should form the ground for taxation, should gross earnings be taxed or should certain deductions be made, and, if any deductions, what are proper? Taxation of gross earnings cannot be considered just, for the operating expenses of any business vary greatly, not only in accordance with the economy of administration but also with the particular kind of business in which the corporation is engaged. The average operating ratio in the case of railroads is about 66 per cent or even higher, while in many wholesale businesses the ratio is negligible, as the cost of operation includes few items other than the salaries of the staff. Corporation taxes cannot provide for the difference in cost of carrying on business, and when distinctions between kinds of enterprises are attempted, justice cannot be secured at all.

Having determined that a net product should be the basis of taxation, it is important to decide whether this fund should consist simply of earnings

after operating expenses are deducted or whether further deductions should be made for fixed charges. Net income is usually taken to mean the amount left after fixed charges of all kinds as well as operating expenses have been deducted. This corporate net income is of a nature similar to the net savings of the individual, after he has subtracted the cost of supporting himself and family. The same reasons which compelled the decision that living expenses should not be deducted from income apply here to show that net income in the usual sense should not be the basis of corporate taxation. Operating expenses should surely be deducted, but fixed charges and other expenses do not stand in the same category. This would leave net operating income as the proper source of state revenue, and in fact most of the states so consider it.

4 Methods of State Taxation

The laws relating to corporate taxation in the various commonwealths are still in a state of chaos. Uniformity in statutes is absolutely lacking, and what one state considers to be the proper object of this kind of taxation its neighbor regards with abhorrence. Any attempt to reduce these various provisions to uniformity must be unsatisfactory, unless details are introduced which are impracticable in a work of this kind. Three general methods of taxation may be distinguished, but these are not exhaustive. In the first place, many of the states tax corporate property in one form or another. It was originally the universal method, still prevalent in many states, to tax on the physical value of the property; i. e., on the realty plus tangible and intangible property. The cost of the property is still taken into account in the local taxation of telephone companies, though this method of determining value has been discarded in most foreign countries where it has been attempted.

Capital stock at its par value is taxed under the general corporation laws of New Jersey; mines and forests in Massachusetts, and banks and savings institutions in Pennsylvania, are subject to the same rule. Capital stock is taxed at its market value in many states for local purposes. The general corporation law of Massachusetts, and the corporation taxes in New York, follow the same rule where dividends are less than 6 per cent. Capital stock plus the bonded debt at its market value is the basis in Pennsylvania, while California and Rhode Island tax the total debt.

Again, in other states, volume of business is taken as the basis of taxation. Savings banks are taxed on their deposits in several of the New

England states. In many states, particular kinds of business are assessed on their volume. For example, deposits of foreign banks are taxed in California, Maine, and New York; deposits of trust companies in New Hampshire and Vermont; the amount insured in the case of insurance companies in Connecticut and Massachusetts; instruments of telegraph companies in Montana; telephone transmitters in Connecticut, Florida, Montana, and Tennessee; number and mileage of cars of sleeping car companies in several southern states; and number of locomotives and passengers of railroads in Delaware.

Finally, earnings form the basis of taxation in other states. Gross earnings, such as gross premiums of insurance companies and gross receipts of public service companies are frequently taxed, while the dividends of gas and electric light companies in Delaware, New Jersey, and New York are subject to taxation. Net earnings of railroads are taxed in Delaware, and of street railroads in Massachusetts and New York; the net earnings of insurance companies are a favorite object of taxation in many states. Franchises are often taxed, but the form varies greatly, as this tax at times takes the form merely of a license fee for incorporation, while at others the true value of the franchise as a social product is considered in its valuation.

5. Corporation Tax in Massachusetts

Probably the best way to illustrate the operation of this tax is to examine its operation in one state, and for this purpose Massachusetts may be chosen. All corporations chartered by the Commonwealth of Massachusetts or organized under its general corporation laws for business or profit, having the capital stock divided into shares, with the exception of savings banks, banks and mutual insurance companies, are subject to an annual franchise tax. The franchise tax is a tax on the remainder of the property of the corporation, as indicated by the market value of outstanding shares, after the deduction of the taxed value of real estate and machinery, which are assessed by local authorities where they are situated. The true value of the corporate franchise is estimated by the tax commissioner on returns from each corporation under oath of its treasurer. These returns indicate the shareholders, number of shares owned, amount of capital stock, par value and market value of the shares, and physical property owned; they are used in connection with the statements of the assessors of each city and town. From the aggregate market value of the

shares determined in this fashion, the commissioner deducts in the case of railroad and telegraph companies whose lines extend beyond the limits of the state, such portions of the whole valuation as is proportional to the length of that part of their line lying without the commonwealth, and an amount equal to the value of real estate located and subject to taxation within the state; in the case of telephone companies so much of the whole valuation as is proportional to the number of telephones used or controlled without the commonwealth, and the value of stock held by it in other companies which have paid a tax; in the case of insurance companies the value of mortgages on real estate subject to local taxation; and in the case of all other corporations, an amount equal to the value of real estate and machinery subject to local taxation within and without the state. The value of the shares remaining after these deductions are made, is called the corporate excess, which is taxed at the average rate of local taxation in the commonwealth.

The amount of the tax which is computed on this corporate excess is collected by the Treasurer of the Commonwealth, and with the certainty of the tax results in a minimum cost of collection. The commonwealth retains that part of the tax represented by the shares owned outside the state, and the remaining proceeds are distributed among the cities and towns in the following manner: First, the proceeds of the tax on railroad, telephone, and telegraph companies is distributed according to the residence of the shareholders; second, the proceeds of the tax on street and electric railways is distributed according to the amount of trackage or mileage in the different cities and towns; third, the proceeds of the tax on business corporations is distributed according to the location of the business. It has been found that the principle of taxation at the source as put into effect in this state has worked out in a very satisfactory manner.

CHAPTER X
THE LAND TAX

THE land tax, popularly known as the * Single Tax, is a proposal of reform by which public revenues sufficient to meet the expenses of government economically administered shall be drawn from ground rent, thus eventually relieving industry of any part of the tax burden. It takes the form of a gradual levy upon the site value of land, construed to include the value of franchises of public service corporations, irrespective of any improvement value.

1. Nature of Ground Rent

Gross ground rent may be defined as the annual site value of land what land is worth for use. It is what the land does or would command for use per annum if offered in the open market. More specifically, it is the annual value of the exclusive use and control of a given area of land, involving the enjoyment of those "rights and privileges thereto pertaining" which are stipulated in every title deed, and which, enumerated specifically, are as follows: right and ease of access to water, health inspection, sewerage, fire protection, police, schools, libraries, museums, parks, playgrounds, steam and electric railway service, gas and electric lighting, telegraph and telephone service, subways, ferries, churches, public schools, private schools, colleges, universities, public buildings utilities which depend for their efficiency and economy on the character of the government, which collectively constitute the economic and social advantages of the land, and which are due to the presence and activity of population, and are inseparable therefrom, including the benefit of proximity to, and command of, facilities for commerce and communication with the world an artificial value created primarily through public expenditure of taxes. As a matter of brevity, the substance of this definition may be conveniently expressed by the single term "proximity."

The followers of Henry George hold that the doctrine of the single tax implies neither nationalization nor common ownership of the soil. Not only is it consistent with private ownership, but private ownership is recognized as necessary to the maximum efficiency of the tax. Even should the entire ground rent of land be taken in taxes there would be no common ownership of land, since the individual title would still carry with it the right to use, control, and dispose of it, subject only as now to the

payment of taxes. As a matter of fact the single tax would probably not absorb all of ground rent, and for several reasons. First, as a source of revenue ground rent seems to be at present far in excess of governmental needs. Second, it would in any case be desirable to leave to the owner of land a certain interest in its rental value in order to insure efficiency and progress in management. Finally, aside from all questions of right, it is evident that to assess and collect ground rent to its full amount would be administratively impossible.

2. The Taxation of Privilege

The land tax has often lacked appreciation on account of its popular designation as a "Single Tax." It is often argued that while land ownership is today a monopoly and may justly be taxed as such, nevertheless it is but one type of monopoly, and in these days of gigantic industrial combinations a minor one. In criticism of the land tax proposal to abolish privilege and secure greater social justice in the distribution of wealth for wages of hand and brain by means of a tax on economic rent, attention is called to numerous other forms of privilege declared to be equally objectionable.

In making answer to this argument the advocate of the land tax points out that land is the heart of the monopoly problem, because the diversion of its rent to private purses is the very core of privilege, and that franchises are ao closely akin to rent through the ties of a common creation by the community that both are appropriate to the same category. The land tax in its larger aspect is represented as a device for securing to society all those values which society has made. The real question at issue is said to be the extent of the social contribution in the creation of taxable values, and not the particular form which those social values may take on. The land tax gains its name not because it is inconsistent with taxation of other forms of privilege, but because privilege in the private appropriation of the net rent of land is of such enormous proportions. For example, it amounted, in 1912, to approximately forty million dollars in Boston, and to more than two hundred million dollars in greater New York. It should be said that there is nothing in the idea of the land tax inconsistent with duties purely for the protection of industry or for the regulation of social morality by discouraging the consumption of liquors.

The charge that confiscation is inherent in the land tax plan is unfounded. If privilege itself is taxed, no confiscation is possible, since by

hypothesis the bearer of the tax burden is in this way only making a return to society of values created by society, to which in the first instance he has no equitable right. No land would be taken, no right of occupancy, use, improvement, sale, or devise; nothing would be appropriated that is conveyed or granted by the title deed. The distinction lies between forfeiture, as implied by the term confiscation, and taxation, or a levy upon citizens to meet the expenses of government.

3. Arguments for the Land Tax

Three major economic reasons are adduced in favor of the land tax. The first is the patent fact that ground rent itself is a creation of the community. When a given place is inaccessible, and social advantages and means of transportation are scanty or negligible, rents will be correspondingly low. But when money has been invested in improvements and a village becomes a town, rent increases *pan passu* with improvements and the need for further governmental expenditures also appears. And so on, until the vast budget of the metropolis is required, and in that metropolis rents are highest of all.

Another established principle is that a tax upon ground rent cannot be shifted upon the tenant by increasing the rent. If it could be, the selling value of land would not be reduced, as it now is, by the capitalized tax that is imposed upon it. Among the objections to most existing tax systems are the impossibility of determining the exact incidence of the tax, and the hardship of double taxation. It is apparent that these difficulties are entirely obviated by the land tax.

The third economic reason is the conceded fact that the selling value of land is an untaxed value. Every purchaser of land makes allowance for the capitalized tax upon it and pays for it a proportionately smaller sum, so that land recently purchased is free from any tax burden. At every change of ownership after the imposition of a new tax, be the period long or short, the new purchase price is reduced by the capitalization of that new tax, which may be said to be thus extinguished by degrees. It is claimed that by repetition of this process taxation may in two or three generations at the farthest cease from being a burden upon any one.

The land tax is a non-repressive tax; it is wholly a tax upon privilege, and can never be a burden upon industry and commerce, nor can it ever operate to reduce the wages of labor or to increase prices. It is furthermore the simplest tax; it would dispense with a horde of tax gatherers, and do

away with the corruption and gross inequality inseparable from present methods.

On the ethical side, the fact that rent is a social product is urged as a reason for its appropriation by society. The value of land is held to be the product of labor invested by society, which is as much entitled to proper return as is individual labor. Class oppression is said to result from the private appropriation of rent; then let society take back its own, and labor and capital will divide between them their joint products in equitable proportion. This was George's favorite argument, although the present tendency of the single tax agitator is to lay stress upon the system as a measure of practical tax reform rather than as a panacea for industrial diseases.

4 The Land Tax In Operation

In England, Germany, Australasia, and Canada the last fifteen or twenty years have seen important changes in methods of taxation which tend in the general direction of the land tax. In England, the Lloyd-George budget of 1909 imposed four different taxes upon land, the first and most important of which is the so-called increment value duty. This imposes a tax of 20 per cent upon land increment arising after 1909, payable by the owner when the land is sold, leased for more than fourteen years, or transferred at death. Land held by corporate bodies and not changing hands is to pay the tax every fifteen years. To carry the law into effect it was necessary to provide for a complete appraisal of all the land in Great Britain, in order to determine its value, exclusive of improvements, in the year 1909. This work, which it is estimated will cost $10,000,000, and will require five years, is now under way, and will result in a monumental survey comparable to Doomsday Book.

In the German Empire recent experiments in taxing the increment made in the model German Colony of Kiao-Chau, China, have led to a general adoption of similar schemes in Germany itself. The land and tax ordinance of 1898 imposed in Kiao-Chau a tax of 33 J per cent of any increment of value accruing thereafter to private purchasers of lands acquired from the government, a tax of 6 per cent on the value of land, exclusive of improvements, and a tax on land sales at auction. This ordinance suddenly and unexpectedly realized the German land reformers' program, in a German colony under the direct control of the imperial government. It naturally aroused great interest in Germany, and soon led to attempts to tax

the unearned increment in various German cities. Frankfort and Cologne took the lead, in 1904 and 1905. Their example was rapidly followed by scores of other municipalities, including most of the large cities, until by 1910 the increment tax was in operation in 457 cities and towns and was yielding a substantial revenue. The rates of taxation ranged from 1 per cent to 25 per cent of the amount of the increment.

In 1911 an imperial increment tax was introduced. The law imposes a progressive tax, increasing according to the percentage which the increment bears to the original value of the land. The rate is 10 per cent of the increment when that amounts to 10 per cent of the original value, and increases 1 per cent for each additional 20 per cent of increment until it reaches 19 per cent on increments ranging from 170 per cent to 190 per cent. From that point it increases 1 per cent for every additional 10 per cent of increment until it reaches 30 per cent on all increments of 290 per cent and over, with a provision for certain deductions. The imperial tax is intended to unify the taxation of the unearned increment throughout the Empire and will replace the local increment taxes. To compensate the cities for the revenue thus lost, the law provides that 40 per cent of the product of the imperial increment tax shall be apportioned to the local governments while the states are given 10 per cent and the Empire retains 50 per cent. Authority is granted, however, to impose additional rates for local purposes, so that some measure of local option is retained.

In Australia, Queensland has already adopted the exemption of all improvements, and the other states as well as the federal government are moving steadily toward this goal.

New Zealand since 1891 has had a graduated state tax which has already to a large extent accomplished its purpose of breaking up large estates. In 1896 local bodies were empowered to levy their rates on the unimproved value of land. By 1909 not less than 85 districts had adopted the method with satisfactory results.

Of the nine Canadian provinces, three have taken important steps toward the single tax. In British Columbia provincial revenue is still derived from poll, property, and income taxes, but since 1891 municipalities have been permitted to exempt improvements from taxation in part or in whole. Since 1892, indeed, municipalities have not been permitted to assess improvements at more than fifty per cent of their actual value. Under the authority thus granted all the important urban and many rural municipalities now exempt improvements, thus raising practically all

local revenue from land. The Government, through its Finance Minister, Hon. Price Ellison, now formally announces its purpose to adopt the single tax for all provincial revenues. He says: "Our aim is to reach a point where direct taxation will be eliminated and our revenues will be obtained from the natural resources of the Province. This I regard as a sound policy."

In the Province of Alberta the same is true of 74 villages and of 44 out of the 46 towns.

In 1912 the province enacted laws, practically without opposition, requiring, with two exceptions, all towns, rural municipalities and villages to raise their local revenues from taxes assessed upon land according to its actual cash value. The five cities of Alberta have special charters granting wide discretion. Edmonton has exempted all improvements since 1904, and the others are following suit. In Saskatchewan about twenty villages confine taxation to land alone. This province has just passed a new act to impose a graduated surtax beginning in 1914 upon unoccupied lands. Its main feature is the imposition of a tax of $40 per section of 640 acres upon land of any owner or occupant exceeding 640 acres, which has less than one-half of its area under cultivation.

In Ontario, 300 municipalities have petitioned for power to reduce taxes on improvements. By twenty-three to one, the Toronto City Council, in January, 1913, submitted to the citizens the question of exempting buildings. An affirmative vote in the ratio of 4 to 1 was the result.

The aim of this chapter has been to give an impartial exposition of the tenets and principles of a specific proposal of taxation. The results of the provincial and largely agricultural tests of the system now in process are favorable. Doubtless the most instructive test will come when some metropolis shall decide upon the gradual transfer of all taxes from intangible and other personalty and improvements to the land, leaving the land tax the only tax.

CHAPTER XI
REFORM TENDENCIES IN TAXATION

IN the earlier chapters it has been shown that the general property tax is the basis of all tax systems of the United States of America. Except in so far as the national government, and to a slight extent some state governments, derive their revenue from indirect taxes, all schemes of taxation countenanced at present bear an intimate relation to the general property tax, which is the keystone of the structure. Were the general property tax to be eliminated at the present time from our system, the other taxes in use would appear at once to be makeshifts, resting on no scientific foundation. Yet the general property tax was designed at a time when economic conditions materially differed from those of the present. Formerly it realized its purpose of measuring the ability of the taxpayer to contribute to public revenues, and its administration was comparatively easy, since the property of each was known to all. Now, however, ability is no longer measured by wealth, nor can wealth itself be discovered. It is evident to all that the basis of our tax systems must be changed. Difference of opinion arises over the proper nature of this change, not over its desirability. Shall it be a radical departure, or shall it be an adjustment of old systems to modern conditions? Reforms have been proposed along both lines, and there is something to be said for each; but the chief tendency seems just now toward an entire change of base.

1. Departures from the General Property Tax

Most important among the proposed substitutes for the general property tax are income taxes, corporation taxes, inheritance taxes, and the land tax. None of these can as yet be said to have reached its final form in the United States, while some of them have hardly passed beyond the stage of discussion. The income tax has been in effect in the British Empire for over a century, and experience has already shown the best methods of adapting it to the needs of that country. In the United States, however, the income tax, while theoretically included in the systems of numerous states, has not until its recent adoption in Wisconsin offered a practical source of revenue. The Wisconsin tax appears to be modeled on proper lines, but it is as yet too soon to forecast its results. Certain it is that it rests on a better basis than its predecessor, but administrative details remain to be settled. Corporation taxes must be considered a less radical departure from the old

tax than income taxes, since they generally offer no improvement on the basis, but consist rather in an attempt to tax wealth at the source instead of in the hands of its owners.

Inheritance taxes are in line with taxation at the source and they further conform almost exactly to the taxation by faculty ideal. Of the new forms of taxation recently put into effect these are perhaps the most desirable, because they satisfy all canons of taxation which are necessary in the case of state and local taxes. Not only is the growing demand for participation by the state in benefits which it has made possible for its subjects recognized by this tax, but that demand is made in its most convenient form. Land taxes have as yet had little opportunity to show their worth in the United States, but they are receiving an ever increasing share of attention, as their value becomes more and more evident from their adoption in foreign countries.

All of these new taxes are as yet imperfect; but the tendencies of reform which they indicate are constantly growing stronger, and the near future will undoubtedly see the incorporation of one or several of them into the tax systems of the American States.

2. Reform of the General Property Tax

Many reform proposals advocate the retention of the general property tax in its main features, but attempt improvements in administration. Better methods of assessment are being adopted in many places where the tax is still retained, and reform of the personal property tax is earnestly sought. Chief among the proposals for better assessment of real property is the Somers System, which was first put into effect in Houston, Texas, and which has recently been introduced in many cities of the middle West. This system has as a unit of computation "the Somers foot" consisting of a block of land, one hundred feet in depth, with one foot frontage on a street, unaffected by the influence of other streets or alleys. The value of this foot is computed by means of mathematical tables, in accordance with its proximity to centers of business and density of population. By this means an equality of assessment is assured and the differences in land values ordinarily resulting from the guesses of assessors are eliminated. The land is taxed separately from the improvements upon it, and, while buildings are not exempted from taxation, there seems to be a tendency in Somers System cities to tax improvements at a rate lower than the land itself. No policy of entire exemption of improvements has as yet been put in effect in

American cities, but experience in Canada and abroad seems to indicate that the time is not far distant when that effort will be made.

Personal property has long been the weakest point in the administration of the general property tax. Evasion and tacit exemption have led to numerous attempts at reform in radically different directions. On the one hand are those who try to enforce the provisions of existing laws to the limit, discovering and taxing all forms of personalty as strictly as possible. On the other hand are those who advocate the abolition of taxes on personal property in the hands of its owners, attempting to recoup for the loss to the government by means of corporation, inheritance, and income taxes. The inadequacy of the present methods of taxation at the source, however, has hindered the general acceptance of this view. Midway between the two are proposals to tax personal incomes at a uniformly low rate, under the belief that there will in this way be less incentive to tax dodging and that an equal return will result, while the honesty of taxpayers will be put to less severe test. Such, for example, is the so-called Pennsylvania or Baltimore plan of taxing securities at a low flat rate, advocated in Massachusetts a few years ago under the name of the three mill tax, when constitutional difficulties prevented its adoption.

3. Improvement of Administration

In the last few years administrative details have received their share of attention. The separation of state and local taxation has been emphasized and efforts made toward eliminating double taxation. The separation of state and local taxes shows to excellent advantage under the new California statute of 1911 whereby state taxes are derived from corporate franchises, banks and public service corporations, whose property is withdrawn from local taxation. It is remarkable that in the first year of operation these taxes coupled with inheritance and poll taxes were sufficient to meet all state expenses and to render possible the abolition of the state general property tax. Whether sufficient elasticity can be acquired by this means yet remains to be seen, but the step seems to be one in the right direction.

Finally, emphasis must be laid upon the work done by state tax commissions and by the National Tax Association. The various state commissions are always headed by an expert and as a rule good work is the result. The National Tax Association, consisting of delegates from the several states and of prominent economists, meets annually. At the

meetings papers are read on vital topics and valuable suggestions for state and national legislation are offered. There is on the whole a strong tendency to put questions relating to taxation into the hands of trained experts who are working out remedies for the shortcomings of the antiquated systems unhappily still in vogue.

CHAPTER XII
REFERENCES

FOR those wishing to study further in the field of taxation, the following books are recommended:

ADAMS, H. C. *Science of Finance*. Holt & Co. 1899.
BULLOCK, C. J. *Selected Readings in Public Finance*. Ginn & Co. 1906.
DANIELS, W. M. *Elements of Public Finance.* Holt & Co. 1911.
FILLEBROWN, C. B. *A B C of Taxation*. Doubleday, Page & Co. 1909.
PLEHN, CARL C. *Introduction to Public Finance*. The Macmillan Co. 1911.
SELIGMAN, E. R. A. *Essays in Taxation*. The Macmillan Co. 1913. *The Income Tax*. The Macmillan Co. 1911. *Shifting and Incidence of Taxation*. The Macmillan Co. 1899.
WELLS, D. A. *Theory and Practice of Taxation*. D. Appleton & Co. 1900.
Reports of Conferences of the National Tax Association.
Reports of Tax Commissions, and Tax Commissioners of the Several States.

This list is not intended to be exhaustive; it merely opens up a wider survey of the literature of taxation than has been possible in the confines of this little book. It was made for the average reader, who wishes to go a little deeper into the subject, not for the expert who wishes particular references to technical details.