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Studying Taxes

By John E. Thompson, Extension Economist

It is frequently pointed out that the success of democracy depends on enlightened judgments. Such judgments can become increasingly difficult as our society expands and becomes more complex. This is certainly the case with many decisions regarding taxation and public spending. For this reason concentration and effort must be used to assist individuals and groups trying to make intelligent recommendations and wise decisions about taxation. This circular suggests one way of studying taxes.

If a tax system is to be fair and provide adequately for the public service needs of society, it must seek to treat all people in the different segments of the economy in a fair and equitable manner and secure from society sufficient tax revenue to meet public service needs. A tax system that attempts to achieve these objectives in a complex society must be complex. Guides used in studying taxes tend to reduce confusion about the system and facilitate wise tax policy judgments.

Those studying taxes need to recognize the nature of changes taking place in the social and economic structure. They should also be aware of the various courses that might be followed in designing a tax system that fits the social and economic conditions.

For real harmony to exist between a tax system and the social and economic base, the tax structure often needs to be changed. To bring about needed changes, a sufficient number of people must consider the change socially desirable and demand it. People must be aware of both the problem and its solutions. The change should be economically feasible—that is, reasonable in relation to the resources available to tax. Finally a tax change must be politically palatable. It must meet with the philosophy of a majority of those empowered to make tax changes.

While social and economic changes are continual and almost automatic, tax system changes come about mainly when the above three conditions exist. This often results in a time lag between the need for adjusting a tax system and an actual change in the system. Sometimes this delay is costly.

Much confusion exists about taxation and government spending in terms of what is, what should be, and what ought to be. Intelligent decisions rise above the confusion when we have knowledge about the tax base, the tax system, and the nature of public services desired. This knowledge is a must in making wise judgments about a tax system or intelligent decisions to change such a system. When we talk about tax policy, we should know what part of the total public finance structure is being considered and where such a discussion fits into the overall picture.

A way for studying state and local taxes is presented to stimulate and facilitate intelligent tax discussions and to assist in developing a solid foundation of knowledge upon which tax judgments can be made.

For example, by following this procedure, you should be in a better position to explain why you think more or less should be spent for this or that service and why you think the sources of money to pay for such services should come from particular taxes.

A STEP-BY-STEP TAX STUDY METHOD

Your study of taxation by this method does not mean you will arrive at the same conclusions as your neighbor. However, by going through the various steps, you should be better informed about what type of tax structure you think is needed and be better prepared to explain and support your particular position.

Also, you are not likely to have the same goals for tax policy. Goals such as “fairness and equity,” “taxing in accordance with ability to pay,” or “basing the tax on benefits received,” all mean different things to different people.

In regard to tax goals, however, it is important to recognize the differences and sometimes conflicts between personal goals and public goals in tax policy considerations. An individual goal might be how to avoid or shift tax payments. This may be an only goal. On the other hand, many people are interested in developing a tax system that is fair and just for everybody called upon to help pay for public services.

Regardless of the goal, an organized method of tax study is important. Such a study should provide information on: (1) the economic tax base, (2) the tax system, and (3) the services that are financed through and by the tax system.

THE ECONOMIC TAX BASE

The economic tax base is where public funds come from (the source) for support of public services. It is the foundation of a tax system. You can easily see that the huge New York tax system, for example, could not be based upon the comparative-
ly small economic resources of South Dakota. You know that needs of a smaller South Dakota population and the amount of money required for many services in this state are completely different from the conditions in more wealthy and heavily populated states. The economic tax base greatly influences the type of tax system and the types of services that can be provided. Thus, a first step for a proper discussion of taxation is to list and inform oneself about resources available to tax.

As all public services are financed by people from their incomes, you must have detailed knowledge about these resources. You must know about the number and age distribution of people and levels and distribution of income. Spending patterns and ownership of property should also be analyzed. In other words you need to know the characteristics of the population.

You can get information about people, their income, and an indication of their spending patterns from several sources. The U. S. Department of Commerce, Bureau of the Census, has information on age distribution, occupations, migration rates, and population density.

For information on incomes, you might use the Survey of Current Business prepared by The Office of Business Economics, U. S. Department of Commerce. Usually the August issue has a breakdown (by states) of income by occupational classes, as well as per capita and total personal income comparisons. The Internal Revenue Service prepares a report, Statistics of Income—Individual Income Tax Returns, that shows distribution of income by broad income classifications. If you are making tax decisions on a strictly local level (community, for instance) information in either the Internal Revenue reports or the Survey of Current Business may be too broad.

A general indication of property ownership in South Dakota can be determined from annual reports of the South Dakota Department of Revenue at Pierre. More local and detailed property ownership information can be obtained from records of county assessors. Special studies may be needed if even more localized data are desired.

State Department of Revenue annual reports show receipts by counties from many state taxes as well as assessments and property tax payments by each unit of government and by classes of property. Additional sources of helpful information for understanding the nature and changes in the economic tax base in South Dakota are listed at the end of this publication.

Answers to the following questions can be of assistance in understanding the economic tax base in South Dakota:

What is the distribution of population by taxpaying and non-taxpaying groups? What proportion of the total population is of school age, retirement age, pre-school age? What are the tax and public spending implications of this?

What are the major sources of income in South Dakota? How does the average per capita income here compare with other states and the national average? What about the stability and trends in state income by major sources? What does this mean in terms of tax and public spending programs?

What are the major types of property ownership in South Dakota? What are the relative earning capacities of these properties? What units of government rely on taxes paid on the properties? How does property ownership and income from property compare by occupations, between states, and between economic areas of the state?

THE TAX SYSTEM

Judgments of merits of a particular tax mean more when they take into account the entire tax system. If you would alter part of a system by adding or changing a particular tax, you should consider the effect such a change would have on the total tax structure and on the economic tax base. All individual taxes have advantages and disadvantages, and affect people of different occupations and different levels of income in various ways.

Disadvantages of a particular tax may be offset by advantages of some other tax. In some cases both of these taxes can give the total tax system better balance. When these offsetting conditions are considered, you are in a better position to judge the entire tax system, rather than only making a decision on the basis of what you discover about a particular tax.

A tax system study should take into account major taxes such as the sales tax, income tax, and property tax. Consider these taxes in terms of their effect on people with various levels of income and by occupation. Important to consider also is—whether the tax system encourages or restricts economic growth and activity.

Information about the South Dakota tax system can be obtained from several places. The annual reports of the Department of Revenue is one. The Bureau of Census publishes annually a Compendium of State Government Finances showing public expenditures and tax revenues by states. The Tax Foundation prepares an annual report, Facts and Figures on Government Finances. Special reports by educational groups and national, regional, and local research groups contain information about tax
systems. The South Dakota Code and its supplements can be helpful in studying tax laws. Commerce Clearing House Inc. and Prentice Hall publish tax reports for each state as well as summary reports for all states. Additional sources are listed in the bibliography.

Important questions to consider in a study of the tax system include:

- What are the major taxes imposed on the population of the state? Are these local, state or national taxes? What taxes are not levied on the local, state and national level?
- What have been the trends in use of, and the revenue yield from, these major taxes in South Dakota? In the nation?
- How do the various taxes affect the various age groups in the community? In the state?
- How do the various taxes affect people within and between major occupations?
- What are the potential revenue yields from changes in rates of existing taxes? In the adoption of new taxes?
- What changes in the tax system appear to be needed to add balance and stability to the entire tax system?

**PUBLIC SERVICES**

The question of why you should study the quality and quantity of public services in order to make wise decisions about taxation in South Dakota is perhaps obvious. However, often proposals for changes in the tax system are made without sufficient consideration given to the effect of such changes on the types and quality of tax supported services.

Sometimes the demand for tax reform comes about when people see the need of a change in financing various types of public services. More often, perhaps, the demand for a change comes about when individuals or groups feel they are being discriminated against because of the nature of the tax structure.

A good tax system is judged on its ability to provide enough revenue in a just and fair manner for public services that society demands. Thus, unless you closely consider the nature, characteristics, changes, and emerging demands of the various public services, your decision about tax reform probably would be poorly supported and perhaps unwise.

In order to make an intelligent judgment about quality, needs, and role of the many public financed services, you should consider at least three of the major types of public services—(1) education, (2) roads and highways, (3) welfare.

**EDUCATION**

An important consideration with education is the part of the economic tax base dealing with school age population. You need to know how public education is financed and what changes are taking place in public school financing. Also think about future needs of public education and how greater efficiencies in providing these services might be found.

A close relationship exists between property taxation and financing public education. Study closely the degree to which society relies on the property tax, the distribution of property among those benefiting from public education, and the degree to which all those within a school district, the county, or even in the state share in financing this important service. As you conduct your study you may want to learn more about why property is used to the extent it is as a base for financing education, what the history of this development is, what the trends are, and what can be expected in the future if public education continues to be financed as it has been.

When you consider financing for any public services, also attempt to formulate how you think the particular services ought to be financed. Do not expect everybody to agree on this. But at least discussing desired objectives about what one thinks is equitable in financing various services helps in formulating consistent tax judgments. For example, should public education be financed according to benefits that society or an individual receives from education? Who really receives the benefits? Should financing a particular type of service be based on ability of individuals to pay such taxes?

If taxing according to ability to pay is the goal, then what exactly is the “ability to pay” picture within a particular school district, county, or state? Perhaps a combination of ability to pay and benefits received is desired. If so, what type of mixture is desired? Cost of administration and using taxes to control or regulate certain types of economic activity are also important aspects to be considered.

Do not overlook the role of federal and state aid in supporting education, highways, or welfare. Also what ought to be the structure of the tax system for financing these essential services when considering (1) universal benefits from economic development, (2) mobility of population, (3) distribution of benefits from public services, and (4) geographical variations in ability to pay.

In your study of financing education, distinguish public education from parochial school education as well as separate elementary, secondary, and higher education. Financing these various educational services usually follows different patterns.

Information about financing public education in South Dakota can be secured from the State Depart-
ment of Public Education, the National Education Association, county officials, those employed by local school systems, and personnel of the Departments of Education at the various institutions of higher education. The *Compendium of State Government Finances* previously mentioned shows the relationship of financing education to the financing of other services and may also be used in making comparisons between the situations in South Dakota and other states.

**ROADS AND HIGHWAYS**

Financing roads and highways is another important public and private concern.

A study of highway financing and needs should first determine what types of roads and highways exist and how well they serve the people of the state. Compare quality and costs with other states. A common question is how to divide total public funds between highways and other services. Attempt to decide the relative values of the various services and try to achieve balance in the total public spending package. Here again the economic tax base needs to be taken into consideration as well as the many public service needs of different age groups.

When one studies this aspect of public finance it is important to consider location of highways in relation to density of population and products to be moved. The need for highways as an aid to future economic development is also important.

Long term trend and projection studies showing the areas of greatest anticipated growth in population and in economic activity greatly help in making decisions about roads and highways. Areas declining in both population and in relative level of economic activity need to be recognized. Think of public expenditures for highways in terms of future needs for farm to market roads, tourist travel, and roads necessary to develop recreation areas. Also, federal aid in highway construction plays an important role.

You can get information about financing and needs of public highways and roads in South Dakota from the State Department of Highways, Bureau of Public Roads, county highway officials, and previously mentioned publications dealing with total expenditures by various services, such as the *Compendium of State Government Finances* and annual reports provided by several departments of state government. The State Auditors and the State Treasurer's report should also be helpful.

**PUBLIC WELFARE**

The third major service, financing public welfare in South Dakota, is broad and rather difficult to understand because of its many programs and lack of uniformity in procedures for financing. However, a general idea of the various public welfare services, the needs of the people for these services, and the methods of raising revenue is vitally important. It is rather meaningless to make a decision about whether the financing of public welfare is adequate without defining the type of welfare service one has in mind.

Special reports in regard to financing several types of public welfare services in South Dakota are available through the State Board of Charities and Corrections. Those include such services as Yankton State Hospital, Redfield State Hospital and School, State Penitentiary, State Soldiers Home, and State Training School at Plankinton. The State Department of Public Welfare and the State Department of Health can provide basic data on the operation and needs of their particular programs. County Commissioners and other county officials can furnish information about the welfare programs carried on by or through county government. Also, the amounts spent by selected public welfare services are tabulated in the *Compendium of State Government Finances*. Trends in expenditures and future financial requirements are usually prepared in special reports by the welfare services themselves.

Several other groups make special studies and submit reports on financing various governmental services in South Dakota. Some of the groups include the Governmental Research Bureau, the General Extension Service, and Business Research Bureau at the University of South Dakota; the Cooperative Extension Service and Economics Department at South Dakota State University; the Greater South Dakota Association, Huron; the South Dakota Education Association, Pierre; and the Legislative Research Council, Pierre.

Your study of public service financing will be far from complete unless you consider changing revenue requirements. Judgments need to be made in regard to future public service needs. Trend and projection studies pertaining to the various welfare programs are valuable aids in estimating future revenue requirements. Planning for future needs prevents undue waste and results in development of public services that help put the economy in a competitive and growing position.

In addition to determine how much has been spent and will be spent if past trends continue, decide how much *should* be spent. There is also the question of whether to continue to rely on the same taxes for future expenditures or whether a new or revised type of tax structure is needed.

A handy, but not all-inclusive, checklist which can be used as your study guide would include these questions relative to financing public services:
1. What are the major services to be financed from tax revenue?
2. How are these services financed?
3. How much will they cost?
4. What do you think is a logical, fair, and just type of tax program to finance such services?
5. What do you consider the proper balance in expenditures for the many different public services?
6. What are the needs of various services?
7. What are fair and just ways of financing future needs?
8. What types and quality and changes in public services would you believe practical, considering the economic base and structure of the tax system?
9. How can we save money and be more efficient in financing various services?
10. How do you relate financing of public services to social and economic development in South Dakota? What should the standards be for establishing priorities in use of public funds?

In your study of the tax system, the economic base, and the various services, avoid getting lost in facts. Try to gather only facts that can be helpful in making decisions about the tax system or financing any particular service.

Presented here is but a brief summary of a procedure or method that may be used by an individual or group of individuals in preparing themselves for wise tax decisions. It is not the only procedure that might be used. However, it should help those wanting to become better informed on state and local public finance problems. It can be used to help individuals and groups studying taxes to recognize the various parts of the total public finance picture. Tax study groups can use this summary as a guide in dividing the tasks of gathering and analyzing data in a way to facilitate a comprehensive analysis of the entire tax system, tax base, and tax financed services. From such a procedure it is expected that improved tax judgments, recommendations, and decisions will evolve.
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