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Taxes, People, Plains, Part III: Decision Making in Public Finance

South Dakota State University Cooperative Extension

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PRINCIPLES FOR DECISION MAKING

Two important types of decisions must be made in public finance at any level of government:
(1) What funds are needed to obtain desired services?
(2) How should government obtain these funds?

The decisions on the level of government spending are reflected in quantity and quality of public services. Through such decisions, personal income is allocated between public and private spending.

When the people decide how revenue is to be raised to pay for public services, they establish how the cost of government shall be distributed. The purposes of this are:
(1) To present a set of principles which citizens can use in making public finance decisions.
(2) To apply public finance principles to major tax alternatives for state and local governments.

DETERMINING THE LEVEL OF SPENDING FOR DESIRED SERVICES

A commonly accepted goal of most democratic societies is to leave public and private spending divided in a way to achieve the greatest amount of "satisfaction" for its people. However, "satisfaction" is a value concept or state of mind which is difficult to measure. Also, conflicts in goals occur among individuals and between individuals and society. Differences exist among families, communities, states, and regions as to need and resources available to support such needs. Government spending is further complicated because benefits of public activity may not be received by those who pay taxes; or benefits may be less than, or greater than, the share of cost of government. Some public activities, such as education, conservation, and resource development, may be paid for by today's taxpayers but primarily benefit future citizens. We attempt to resolve these conflicts by compromise through our political processes.

Since we buy public services through government, we have to tell our wants to our elected representatives, be they school board members, county commissioners, city councilmen, or state legislators. We do this by talking to our elected representatives and by forming lobbies with other individuals of similar interest to inform officials and legislators. Views for or against any government expenditures can be brought out at public hearings. Each of us should recognize that decisions will be made whether we participate actively or not in the political process. If we wish to influence these decisions, we must actively participate. Abraham Lincoln once said: "What I want is to get done what the people desire to have done, and the question for me is how to find that out exactly."
Public hearings are held on most matters that affect state and local spending. These public hearings are extremely important. They permit expression of the interests of the people.

Procedures should be established for effectively evaluating expenditures as they are being made. Such procedures are especially important because government does not have the profit measure used by private business for checking performance. As government activities widen, safeguards become more important.

Our elected representatives, in determining the amount of government spending, should gather and evaluate information, weigh conflicting views, and determine whether or not the expenditures will do the job intended. Government expenditures are economic if they directly or indirectly increase the productivity of the economy more than would the same expenditures in the private sector. This is hard to judge. Government expenditures for flood control, education, and roads can be classified as economic by this definition.

Besides this economic consideration in determining government spending, upper limits are influenced by reactions of the individual, the market, and society.

The individual usually thinks more about the taxes he has to pay than the benefits he receives from public services.

The market also provides a limitation on government spending. For example, welfare or unemployment payments greater than the current wage rate would disrupt the labor market. There are, however, no set rules for these limits, which again means that value judgments must be made by our legislators.

Society, through government, places legal limits upon expenditures. These may take several forms such as: ceilings on indebtedness, maximum or fixed rates for state sales, income, and property taxes.

**SOURCES OF REVENUE**

Once the level of government spending has been determined, government activities have to be financed. Part of the finances come from nontax sources, including licenses and permits, fees, and fines. Licenses and permits are used both for revenue and for regulation and control. These include business and occupation licenses and permits, hunting and fishing licenses, motor vehicle registrations, and drivers' licenses. Individuals and firms obtaining a license or permit acquire certain privileges. Fees are charges for services performed by public agencies. Examples are student fees at the universities and colleges, and fees for bonding, title transfers, and recording deeds. Fines are the penalties for not conforming to law.

The difference between this nontax revenue and what the government spends must be made up by taxation, borrowing, or spending of reserves. Thus the main purpose of taxation is to obtain revenue to fulfill the policy objectives of government.

Taxation sometimes is used to achieve economic and social reforms. Trying to achieve these reforms by discouraging certain activities or consumption through high tax rates may increase the tax revenue (e.g. cigarette and liquor taxes) if the high rates are not effective in reducing consumption. Encouraging or promoting certain activities through low tax rates or exemptions often lowers the amount of tax revenue. Exemptions and special low rates on certain items or tax categories will narrow the tax base, and, consequently, increase the tax rate for others. Taxation should be used for social reform only after careful consideration of its effects on the total tax system.

Taxes are usually levied on what's owned (property), what's spent (consumption), and what's received (income). Property may be bank savings, real estate, stocks and bonds, or any other possession which is a reserve of purchasing power. Property taxes and income taxes on dividends and interest are examples of taxes on wealth. Death, estate, inheritance, and gift taxes are taxes on the transfer of wealth. Taxes on consumption include the general retail sales tax, specific sales taxes on gasoline, liquor, tobacco and luxuries, use taxes, and taxes on gross receipts. Taxes on production include the income tax, grain and seed taxes, and severance taxes on oil, gas, minerals, and timber. The head, or poll tax, does not fit in any of these categories.

**PRINCIPLES FOR EVALUATING A TAX SYSTEM**

Any tax system should be evaluated from the viewpoint of the individual, the government, and society in general. These viewpoints occasionally will conflict and require careful study by policy making bodies to determine whose interests should take precedence.

**Viewpoint of the Individual.** Most discussions of the principles of taxation include the famous tax canons or principles stated in 1776 by Adam Smith in his book, *The Wealth of Nations*. These principles have withstood the changes of time quite well, particularly as they apply to the requirements of the individual. According to Smith, a tax should be: (1) equitable, (2) economical, (3) convenient, (4) certain.

**Equity.** Equity or fairness is probably the most important quality of a tax from the viewpoint of the individual. This means taxes should be levied according to common notions of justice. Ability to pay and benefits received are the two basic concepts underlying equity. As stated by Smith:

"The subjects (citizens) of every state ought to contribute toward the support of the govern-
ment as nearly as possible in proportion of their respective abilities; that is, in proportion to the revenue they respectively enjoy under the protection of the State."

Ownership of property is one measure of ability to pay, but is not a perfect one. The productive use (farm or business) or consumptive use (home) and the amount of indebtedness on property influences ability-to-pay. Also property is an imperfect measure of ability to pay because there are many other sources of income.

People with high incomes obviously have the ability to pay more taxes than people with low incomes. In addition they can be considered able to pay a higher proportion of their income in taxes. This leads us to define a progressive tax and regressive tax. A progressive tax takes a larger percentage of income from people with high incomes than from those with low incomes and thus follows the ability-to-pay principle. The federal income tax is an example. A regressive tax takes a larger percentage of income from low-income people and consequently does not meet the ability-to-pay test of equity or justice. The general retail sales tax is regressive in effect.

A proportional tax is one which takes the same percentage regardless of the level of income.

The second concept of equity in taxation—benefits received—is based upon the idea that those who benefit from government services should pay the cost of providing them. When government was primarily concerned with keeping the peace, enforcing contracts, and maintaining internal and external security, property owners could be considered as the group benefiting most from government services and therefore paying most of the governmental costs.

In modern society, government has expanded into social welfare fields where people receiving large amounts of benefits cannot pay for them. The burden then falls on society as a whole, which benefits indirectly from these programs.

Several taxes are now used which are very rough measures of benefits received. Among these are the gasoline tax for highway construction, postal charges for mail service, student fees for part of public education costs, and specific property tax levies for irrigation, fire protection, drainage, and other similar functions.

Another concept related to equity is that there be widespread participation by citizens in paying government costs.

Economy. Adam Smith had this to say about economy:

"Every tax ought to be so contrived as both 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."

In other words, administering the tax should use up the smallest possible part of the total proceeds of the tax. Public finance experts generally agree a tax which costs less than 3% for administration is an economical tax and meets this test.

Convenience. Again Adam Smith writes:

"Every tax should be levied at a time, or in a manner in which it is most likely to be convenient for the taxpayer to pay it."

The federal withholding tax on wages and salaries and the timing of property tax due dates in many states are examples of attempts to make tax paying convenient.

Certainty. To quote Smith again:

"The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every person."

This criterion includes the requirement that the taxpayer should clearly understand the amount of tax required and how and when it should be paid. Simplicity is an important virtue when dealing with the masses of people involved in taxation but it is not easily realized. Each new law that provides special classifications and exemptions adds confusion and complexity to the property tax. Special treatment of dividends, capital gains, retirement income, etc., tends to complicate the income tax. Exempting food, clothing, and other items from the sales tax is intended to remove inequities, but causes serious problems of administration.

Viewpoint of Government. The tax requirements of governmental units coincide in some respects with those of the individual but conflict in other ways. The executive and legislative branches of government are most concerned that a tax system should be: (1) adequate, (2) flexible, (3) stable, and (4) easy to administer.

Adequacy. An adequate tax system provides enough money during a fiscal period to enable administrative officials to carry out their responsibilities. If tax revenues are not large enough to finance the quantity and quality of services desired, appropriate legislative and administrative authorities have two alternative courses of action:

(1) Raising rates of existing taxes or imposing new ones.
(2) Restricting the scope and/or reducing the quality of services offered.
**Flexibility.** A flexible source of revenue is one that can be changed easily to meet changing governmental needs. A nonflexible tax system would result in unplanned surpluses and deficits. The property tax is flexible to the extent governmental units can meet changes in revenue needs by raising or lowering the mill levy within statutory limits. The sales tax is relatively inflexible because the rate is usually set by law and can be changed only by new legislation.

**Stability.** Stability of taxes refers to the effect changes in economic conditions have upon revenue yields. The Great Plains States, with wide fluctuations in annual rainfall and with other weather and price hazards, may experience substantial year-to-year variations in economic conditions. Progressive income taxes are more sensitive to changes in economic conditions than are sales taxes, and sales tax yields respond to changing economic activity more readily than property tax yield. This criterion for a tax system conflicts with the individual needs since a stable tax (like the property tax) in time of reduced income burdens the individual with a fixed cost.

**Ease of Administration.** Usually, the simpler the administration of a tax system the lower will be the administrative cost. Effective administration also is important from the standpoint of equity. No matter how equitable a tax structure appears in form, it is not actually equitable if there is substantial evasion or avoidance of the tax. Generally, the cost of enforcement should not exceed the additional revenue obtained from enforcement. This is not a hard and fast rule, however, because strict enforcement not only obtains more revenue from persons trying to evade or avoid the tax but also insures more complete compliance and respect from other taxpayers. Most people pay their taxes more willingly if they feel that they are receiving equitable treatment.

Ease of administration varies with the level of government involved in a particular tax. The property tax is adapted to administration at the local level, while sales and income taxes are generally difficult to administer locally. Administration of the income tax is less difficult and less expensive at the state level if it can be tied to the federal income tax. Ease of administration, however important, should not override other desirable criteria.

**Viewpoint of Society.** For society in general, a tax system should be considered in light of its: (1) effect on economic growth; (2) impartiality; (3) impact, shifting, and incidence; and (4) use for social reform. These criteria also are important to the individual and government.

**Economic Growth.** Economic growth is often defined as the increase in the per capita production of goods and services. This is usually associated with larger investments per worker. These investments may be private or public investments in facilities and equipment.

Taxation should help economic growth. This means revenue should be large enough and spent in such a way as to provide minimum economic stimulation and growth for both the public and private sectors of the economy. Public expenditures such as for education and roads often provide incentives for private investment. Impact of taxes upon economic growth varies with type of tax, tax rate, and type of industry. One type of tax may favor one industry while it retards the development of another.

**Impartiality of Treatment—Equal Treatment of Equals.** Taxes generally should be neutral (nondiscriminatory) among individuals and industries. However, in practice, nondiscrimination is difficult to achieve because economic situations (income, debt, assets) are often very different. Some industries, like lumber yards and farming, require a high investment per worker and have a slow capital turnover. These industries may be hit hard by a property tax unless the tax can be shifted. Other businesses, like grocery and variety stores, have a rapid turnover and a low profit per sale, so they may object to gross receipts taxes. Still other occupations, like commission firms, insurance, and personal service, have a small investment (except investment in education) but a comparatively large income per worker. People in such occupations are likely to object to an income tax, if they look at it only from the individual viewpoint.

The head or poll tax gives the same treatment to taxpayers who are essentially different because of wealth or income and is an example of a nonneutral tax. The property tax with a high rate of tangible property (house, farm) and a low rate of intangible property (bank deposits) may give unequal treatment to two taxpayers who have similar income and wealth but different forms of investment.

Although none of our present taxes are completely neutral, certain standards have been established to distinguish between groups and classes of property or income. Most of all, tax differentiation must be relevant. There should not be a classification for example, which applies a higher tax to one man because he is taller or because his name is Jones instead of Williams. Constitutional requirements that taxes shall be uniform have been interpreted by the courts to mean that all persons or property within a certain class, such as those having the same income or obtaining income from stocks and bonds, shall pay equal tax rates. In the case of identical incomes the classification is reasonable, but the classification between investment in real estate or intangible property is somewhat more doubtful.
**Impact, Shifting, and Incidence.** The tax impact is on the first person or firm to pay the tax. But the person or firm liable for the tax payment may be able to shift the tax to someone else.

*Incidence* is the final resting place of a tax. This final resting place is ultimately on people, even though the original tax may be on business. Shifting of the tax to someone else may be done legally by avoiding the tax or illegally by evading the tax. In either case the tax is shifted to other taxpayers.

Part or all of a tax on business may be shifted to the consumer by charging more if the consumer is local and relatively “captive.” Some of the tax may be shifted to the supplier of products and labor by paying lower prices. Moving to areas with lower tax rates is another way of avoiding a tax. This is seen when people and businesses move outside the city limits to avoid city taxes.

Taxes are also shifted illegally by evasion. Examples are: not filing a return, filing incomplete returns, under-reporting of income, over-reporting expenses, and under-reporting of personal tangible and intangible property.

The incidence of a tax describes who finally pays it after all shifting has been completed. In some cases the tax cannot be shifted. Then, the impact and the incidence would be on the same individual. Some people or industries cannot shift property tax—homeowners, for example. Agriculture and industries which compete in a national market are also examples of businesses that cannot effectively add state and local taxes to the price of goods or services sold.

Taxes levied on corporations or other types of business firms and on professional and service groups are usually passed on. In a highly competitive market, most corporate income taxes may be passed on to owners or stockholders. In a market where the firm may be one of the few sellers (e.g. grocery stores) facing many buyers (consumers), most business taxes are shifted to consumers. In a market where the firm is one of few buyers (such as a grain elevator or meat packer) facing many sellers (farmers and ranchers), most business taxes are shifted to producers. Some of the tax may be shifted to the employees in the form of lower wages or fewer jobs.

The incidence of any tax should be determined; otherwise the tax may unknowingly be inequitable and retard economic growth.

**Social Reform.** Taxes are sometimes used for social reform by applying low rates and exemptions to encourage certain activities and applying high rates to discourage others. Using taxes to accomplish social reform has always been controversial. Those who oppose it claim the revenue purpose is complicated enough without the added confusion of non-revenue purposes. Those who favor social reform through the taxing system claim this is often the only way reform can be brought about and many reforms can be designed which will not interfere with the revenue system.

Several taxes, originally enacted to bring about social reform—such as cigarette and liquor taxes—developed into lucrative sources of revenue.

Social reform should not be the major criteria for evaluating a good tax system. If a tax for social reform purposes is likely to produce confusion and unduly interfere with revenue raising, other methods of accomplishing social reform should be used.

**CHARACTERISTICS OF MAJOR STATE AND LOCAL TAXES**

**PROPERTY TAX**

The origin of the property tax is lost in antiquity. However, rulers have always required revenue and they have frequently collected this on the basis of control over property exercised by their subordinates. In the United States during the 19th Century and earlier, the property tax formed the main basis for government revenues. It still remains a major source of local government revenue.

In recent years, the general pattern of development has been for tax systems to depend less and less upon property taxes, but it seems likely that the property tax will remain an important local government revenue source.

Uniform taxation of all property might be expected in application of property taxes, but usual practice is to classify property into: (1) real property (land and permanent improvements); (2) tangible personal property (business inventories and equipment, motor vehicles, farm machinery, livestock, etc.); (3) intangible personal property (cash, bank deposits, stocks, bonds, etc.).

The base of the property tax is wealth or, at least, nominal ownership of property rather than income. Thus, mortgage debts ordinarily cannot be used to reduce taxable value. The value for tax purposes is usually market value of property, although in some cases, capitalized earnings may be used as a partial basis.

The bill for property taxes sent to an individual is expressed in dollars due. It is derived by multiplying the “assessed” or “taxable” value of the property by the appropriate tax rate. Rates are expressed in mills (10 mills equal 1 cent) per 1 dollar of assessed valuation. Mill levies can be, and frequently are, translated into dollar terms and expressed as dollars per $1,000 of assessed valuation.

While there are many departures from the original concept of uniformity in property taxation, at-
tempts are made to achieve uniformity within classes of property. Frequently certain kinds of property within the various classes are exempted from taxation and seldom do the same tax rates apply to all classes of property.

The property tax is an impersonal tax. Taxing jurisdiction is determined by the location of the property, not residence of the owner. The tax becomes a lien against the property, not against the owner's general assets.

In most states assessment and valuation of property is made locally with guidance from state authorities who attempt to see procedures are consistent throughout the state. It becomes very important that valuations be consistent because many state governments receive a portion of the local property taxes. In addition, state funds frequently are distributed by formula which takes into account local capacity to raise tax revenues. To illustrate, assume (1) there are uniform tax rates state-wide, (2) local property taxes provide some state revenue, and (3) there is state aid to local units based in part on ability to raise revenues locally. Under these conditions, a county that assesses its property low relative to all other counties in the state would (1) pay less than its fair share of taxes to the state and (2) receive greater than its fair share of state aid.

County or township assessors usually make property listings and valuations. Property owners then have the option of accepting the valuation or appealing.

Generally, attempts are made to equalize assessments among various taxing units and classes of property.

For the individual citizen, property tax represents a familiar part of his state and local tax system. It bears a close relationship to expenditures for many local public services and, thus, gives the individual some opportunity to perform his own cost-benefit analysis.

If an individual's income is derived primarily from sources not subject to property tax, it means low property taxes. If, on the other hand, an individual's income is derived principally from sources subject to property tax, it means a high property tax. Thus, the property tax frequently suffers from failure to meet the test of equity or fairness measured by either ability to pay or benefits received.

In the words of the late Senator Robert A. Taft of Ohio:

"The mere fact of owning property is not necessarily a valid indication of ability to pay taxes. Property taxes came into existence almost simultaneously with the birth of 'private property,' and were for centuries the most fair and workable form of taxation. Now, however, we live in an era in which a man can amass millions of dollars without owning anything but a pencil and a sheet of paper. Obviously, then, possession of property alone does not testify to ability to pay."

The property tax does not treat all taxpayers alike. There tends to be heavy impact on farmers, home owners, and others with little or no opportunity to shift taxes. Some businesses are taxed on production, others on total investment, and some virtually not at all.

The property tax is regressive. Drought, economic conditions, decline in earning power due to old age, sickness, death, etc., can change the average taxpayer's ability to pay. The property tax does not reflect such changes and consequently often results in higher tax payments by low income persons relative to those with higher incomes. The assessment of low value property tends to be at or above actual value while high value property tends to be undervalued. This further tends to make the property tax regressive, especially as it applies to homes.

When property taxes are included in house payments, home owners may be unaware of the amount of their property tax. In addition, renters who pay a property tax indirectly on homes and other property frequently are unaware of how the property tax is shifted to them.

From governmental standpoint, the property tax provides flexibility. Unless prevented by statutory or constitutional provisions, the rate can easily be raised or lowered to meet revenue needs. In addition, property tax provides considerable revenue stability because property values change slowly from year to year and real estate cannot be moved from the taxing district. However, there are instances of movable property being shifted from one district to another on dates of assessment in order to take advantage of lower tax rates, different assessment dates, or to avoid the tax completely. The property tax provides a relatively stable source of revenue because taxes are due regardless of economic conditions. Such revenue is not subject to the fluctuations in income.

Property provides a large tax base and, therefore, is capable of yielding large amounts of revenue.

Administration of property taxes at the local level does not insure good administration, but it does allow local people to see what is going on. It is difficult to obtain complete assessment of all property, especially the tangible and intangible personal property. Determining the value of a wide range of items used in modern businesses, professions, and households is an extremely difficult matter. It becomes a
matter of judgment on which there can be honest differences of opinion. The most explicitly written property tax laws do not preclude this difficulty or insure equitable treatment of taxpayers.

As with any local governmental office calling for special skills and open to the nonprofessional, there are problems of guaranteeing adequate qualifications for tax assessors. In addition, pay is often too low to develop and hold competent people. There is also danger an assessor who does a good job of assessing may not be re-elected precisely because he did a good job. This means political pressure can more easily be brought to bear on those administering the property tax than on an income or sales tax.

From the standpoint of society, there is some tendency for the property tax to encourage businesses and industries which require smaller amounts of tangible property. If tax rates and procedures vary between taxing units, there is some tendency for businesses requiring large investments in tangible property to locate in districts with lower tax rates.

Taxes are by no means the most important factor in locational choice, important as they are. John Due, an authority on public finance, summarized studies of tax influence on location in the June 1961 issue of the National Tax Journal, including these three general conclusions:

1. . . . It is obvious that relatively high business tax levels do not have the disastrous effects often claimed for them. While the statistical analysis and study of location factors are by no means conclusive, they suggest very strongly that the tax effect cannot be of major importance.

2. However, without doubt, in some instance the tax element plays the deciding role in determining the optimum location, since other factors balance. This is most likely to be the case in the selection of the precise site in a metropolitan area (property taxes being the ones of chief concern), or when a suitable area for site location straddles a state border. But state and local taxes represent such a small percentage of total costs that the cases in which they are controlling cannot be very significant.

3. The tax climate factor, as one element in the general business reputation or climate of the state, without doubt influences some location decision making, by causing firms to exclude certain states or urban areas from consideration. Again, these cases are probably not a significant portion of the total.

The property tax has the effect of giving somewhat differential treatment to organizations using tax exempt property, e.g., religious, charitable, and educational organizations.

Last, but not least, the property tax may sometimes have the effect of discouraging addition to or maintenance of property. For example, a person may be reluctant to paint or improve his house if he figures that, in addition to the initial costs, it is going to increase his taxes.

In summary, the property tax, although starting with a fairly simple idea, has become complex. It is not necessarily based on ability to pay or benefits received.

Inequality of assessments and uneven distribution of property in relation to revenue needs are possible when property taxes are used. Certainty of revenue is one of the chief assets of this tax. Widespread participation is dependent upon the distribution of property ownership and the extent to which shifting is possible.

INCOME TAX

Individual income taxes are used by over 70% of the states and by some municipalities. Corporate income taxes are imposed by about four-fifths of the states.

Income is generally defined as the total economic gain of a person or corporation during a specified period. Items usually included in income are: (1) total receipts less expenses of earning this amount; (2) the value of perquisites or consumption items and services such as the rental value of a house, home-produced food, etc.; and (3) increase in the value of assets (capital gains). The usual pattern is for an income tax to apply to income actually earned plus any capital gains on assets sold during the period.

The characteristics of an income tax, either individual or corporate, are heavily dependent upon whether it is based upon gross income or net income. The common practice is to base it upon net income. Thus, income taxes based on net income closely adhere to the ability-to-pay criterion. Income tax payments may bear little direct relationship to benefits received from government. Widespread participation in paying the total tax bill will depend on the level of income and exemptions allowed.

The income tax would not be a stable source of revenue in situations of high income variability, unless it were easy to vary the rates. Aggregate income in the Plains States does not vary as much as individual incomes; thus, a fixed rate income tax is a fairly stable revenue source for state governments.

It is possible to make income tax rates progressive, proportional, or regressive. The usual approach is to make state income taxes progressive but much less so than the federal income tax.
The corporate income tax is similar to individual income taxes but, since it taxes corporate earnings, it may have different effects. It provides a means of taxing out-of-state corporations earning income in the state. It provides access to a large body of taxable wealth, and it may make the individual income tax somewhat more politically acceptable.

It may be argued a corporate income tax is shifted to stockholders, suppliers, employees, and consumers, and needed revenue can be obtained more equitably through an individual income tax. There is some difficulty administering this tax when a corporation does business in more than one state. Excessive corporation income taxing can deter the location of economic activity within a particular tax jurisdiction.

GENERAL RETAIL SALES AND USE TAXES

The sales tax is, in effect, a tax on spending. To the individual paying this tax, it appears as part of the price of the item. The usual procedure is to apply the tax to items bought for consumption rather than resale and to exempt producers' goods. This is not always done effectively. In addition, it is rather common practice to exempt certain classes of items from a sales tax. For instance, food is sometimes exempted in order to decrease the regressivity of the sales tax. This is done because it falls heaviest on low income groups and large families who spend a higher percentage of their income for consumption goods. Again, this regressivity can be partially offset if, in addition to tangible consumption goods, services are also made subject to a sales tax. This is becoming more common.

The general procedure for collecting the sales tax is for the seller to collect the tax at the time of sale and remit the revenue to the taxing unit.

From the individual's standpoint, the sales tax may be considered convenient since it is a small tax paid with each purchase. Or it may be considered a nuisance since it must be paid with each purchase. It is a simple tax and easy to understand. It provides widespread participation in the paying of tax revenues.

A chief disadvantage of the sales tax is the tendency for it to take a larger share of the incomes of low income individuals and those with large families. Thus, the sales tax is referred to as regressive.

From the standpoint of the taxing unit, it is a fairly easy tax to administer; and it is a relatively stable source of revenue because of the large tax base which it taps. It is relatively economical for government to collect since most of the collection problems fall with those making sales.

The sales tax is not well adapted to local government use unless it is administered by the state, since its effect would be to shift purchases from one taxing unit to another. In practice, the sales tax is not flexible since the rate is set by law and difficult to change.

Because there is some possibility of buying out-of-state where nonresidents may not be subject to the sales tax, many states have resorted to a use tax. This is essentially an attempt by the home state to collect the sales tax that it would have collected had the sale been made within the home state. For instance, the incentive to buy a car out-of-state and avoid sales tax is eliminated if the purchaser knows when he registers the car he will have to pay a use tax equal to the sales tax on a car purchased in his own state.

From the standpoint of society, a sales tax does not appear to retard economic growth if it does not apply to producer purchases. However, there may be some tendency to encourage spending for nonsales tax purchases or services and encourage more savings.

In summary, retail sales and use taxes tend to be regressive and generally are not based on ability to pay. However, persons in lower income brackets who spend a larger percentage on subsistence and, thus, pay more sales tax relative to income, tend to pay relatively less property and income taxes. This means that a sales tax as part of a total tax system may not violate the ability to pay criterion as much as a look at the sales tax alone might lead one to believe. The sales tax does make it possible for all members of society to support the governmental activities which they demand.

The sales tax is easily administered and it tends to produce a fairly even flow of revenues.

SPECIAL SALES TAXES

Special sales taxes are similar to general retail sales taxes except that they tend to be somewhat less regressive. An example of the special tax is the motor fuel tax which, in most instances, adheres most closely to the benefits received criterion. Its revenue goes primarily to support roads used by fuel buyers. Other special taxes include those on alcoholic beverages, tobaccos, and entertainment. These taxes tend to be good revenue producers because they usually apply to a product which people continue to buy even though the price goes up as a result of the tax.