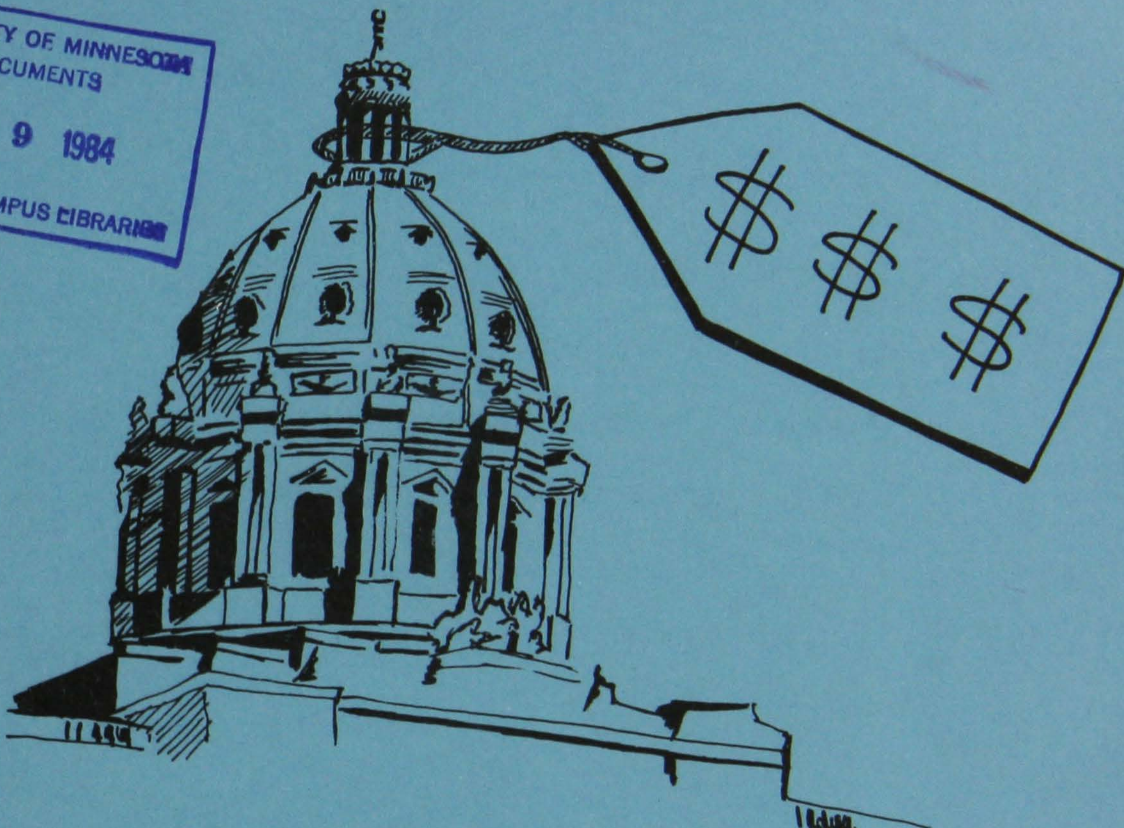
THE PRICE OF GOVERNMENT

A Brief View of Minnesota State Taxation



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E R R A T A

The following typographical errors appear as indicated:

Pg. 11, pgh 2, last line beginning "undesirable effect of" should read: "on" instead of "of".

Pg. 13, pgh 1, 2nd line beginning "regressive. For example", etc., should read: "progressive" instead of "regressive", changing the following sentence to read: "For example, Sen. Paul Douglas sought to demonstrate their regressiveness to a Senate", etc., substituting "their regressiveness" for "this."

Pg. 14, pgh 2, line 4, beginning "are some arguments" should read: "of a unit of" instead of "unity".

Same page, last pgh (quoted material), 5th line beginning "(both) imposes not burdens" should read: "imposes net burdens" changing "not" to "net".

Pg. 21, last pgh, line 2 beginning "state government" should read: "produced" instead of "produces".

Pg. 28, pgh 4 (second quoted pgh), line 2, beginning "Minnesota, it is said" should read: "...it influences the" instead of "...if influence the".

Pg. 29, pgh 2, line 3 beginning "tax revenue" should read "statutory rate varied from one per cent in the lowest" instead of "rate was set at one to 10 per cent from the lowest" etc.

Pg. 34, pgh 2, 6th line beginning "encourage it by" should read: "substituting a one cent", etc., inserting "a".

Pg. 36, pgh 3, line 1, beginning "Method of taxation" should read: "The method of taxation of a mining industry", inserting "The" and correcting spelling of "industry."

Pg. 39, pgh 2, line 8, beginning: "The Governor's Tax Study" should read: "in 1954, railroads paid higher" deleting "a".

Pg. 42, pgh 1, line 3 beginning "biennium show" should read: "data of the Association predicted" instead of "predict"; and in the 5th line, "is expected to have" should be changed to read "would receive."

Pg. 44, pgh 1, 3rd line beginning "Revenues" should read: "Revenue" deleting "s".

Pg. 49, 1st pgh, next-to-last line beginning: "tax can be made regressive" should read: "can be made progressive" changing "regressive" to "progressive".

THE PRICE OF GOVERNMENT

REVENUE PRACTICES OF STATE GOVERNMENTS GENERALLY

State governments usually get the money they spend from two sources, non-tax and tax. Besides tax revenues, Minnesota for example receives money from the sale of timber on state-owned lands; by selling various goods and services to visitors at some state parks; by leasing iron ore lands owned by the state, and so on. A source of considerable importance to any state is the federal grant-in-aid. In fiscal 1959, the federal government turned over $5.8-billion to the states, usually to match contributions set aside by state legislatures for agreed purposes. Using Minnesota as an example again, fiscal 1959 saw Minnesota receive $129-million in federal aid while taking in more than $313-million in taxes.

There are a variety of other non-tax sources besides federal aid. State courts which impose fines usually funnel some portion of the fine to the state treasury. Almost every state invests funds in securities and institutions and receives interest on the investment. Like individuals and private businesses, state governments borrow money for various purposes like financing building programs. States -- also like individuals and private businesses -- engage in short-term borrowing to meet temporary "cash" shortages.

But taxes are by far the most important source of money for state governments. The following chart indicates general magnitudes:

TABLE 1. Where State Governments Got Their Money in Fiscal 1959[1]

Source	Amount	Per Capita
GENERAL REVENUES		
Taxes	$15,848,000,000	$90.29
Intergovernmental From U. S. $5,888,000,000 From local 364,000,000	6,252,000,000	35.62
Charges & misc. revenues	2,348,000,000	13.38
INSURANCE TRUST REVENUES	3,631,000,000	20.69
LIQUOR STORE REVENUES	1,085,000,000	6.18
Total Revenues	$29,164,000,000	$166.15
BORROWING	2,249,000,000	12.81
TOTAL REVENUE & BORROWING	$31,413,000,000	$178.96

Taxes provided almost two-thirds of the revenues from sources exclusive of insurance trusts, liquor stores, and borrowing. Although this memorandum, as well as most brief discussions of taxation, focuses on taxing as a way to raise money so that it can be spent, two other uses of taxation are politically important. First, governments use taxation to encourage or discourage private spending for various purposes. For example, a state with an important peanut oil and margarine industry might want to encourage its citizens to use oleomargarine rather than butter as a table spread. The state legislature could help do this by taxing table spreads according to their percentage of non-peanut fats and oils. In this instance, a spread like butter (having no peanut oil content) would have a tax added to its price, reinforcing

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1. Data: Bureau of the Census, Compendium of State Governmental Finances in 1959 (State Finances 1959: G-SF59-No. 2), Table 1.

the price advantage of margarine and possibly making butter prohibitively expensive. A second use of taxation is to redistribute economic goods or wealth. Opponents of free, compulsory public schooling at one time attacked taxation of property for this purpose as a device for economic redistribution.

Not only can legislative bodies deliberately employ taxation for these two policy purposes, but also you should note that most taxes and tax proposals are conceived to have such effects. People thus tend to support or oppose tax legislation on the ground of its supposed social effects.

Some General Characteristics of State Taxation

Both state constitutions and the U.S. Constitution limit the taxing powers of state governments. Appendix ONE summarizes these limits. Judicial decisions interpreting constitutions add additional restrictions and distinctions. Thus, state legislatures are not legally free to tax in any way which recommends itself at a particular time. In addition, tax administrators have accumulated knowledge about administrative feasibility from decades of trial and error experience. Therefore, administrative considerations also are added to the limits within which state legislatures approach the job of raising revenues.

Nevertheless, the state legislators have been ingenious in devising kinds of taxation. The following summary of 1959 practices does not exhaust the variety:

1. Taxes on income: Thirty-two states levied personal income taxes to raise $1,763,554,000. Thirty-six states, more than the number having personal income taxes, used taxation of corporation net income to raise more than $1-billion dollars. This combined to produce a total of about $2.8-billion of the total of $15.8-billion of state tax receipts, that is, about 17 per cent.

2. Taxes on property: Forty-five states levied property taxes to raise $565,934,000. At the turn of the century state governments received about nine-tenths of all of their tax revenue from taxes on real and personal property, but this tax in fiscal 1959 accounted for only about 3.6 per cent of tax collections of state governments. Many state legislatures have tended to leave the property tax to local governments which have experienced greater and greater financial pressures.

3. Consumption taxes: Harold M. Groves' list of a dozen kinds of consumption taxes is reproduced as Appendix Two. Most of these were employed in fiscal 1959 by at least one state government. This variety shows why classifying taxes is hard and why we don't exhaust the possibilities of such taxes by talking only about excises, sales taxes, and the like. The use of such taxes in fiscal 1959 by some 49 states (categorized as sales and gross receipts taxes) raised $9,286,650,000 -- the largest single category of tax revenues.

4. Licenses: Forty-nine states raised $2,320,386,000 by imposing charges for various kinds of licenses, the auto license being the most familiar. Licenses usually are regarded as charges for exercising various privileges, thus your auto license represents a charge for operating your car on the public roads. There are also various kinds of public utility franchises; fishing and hunting licenses, and licenses to exercise various kinds of occupations and professions.

5. Miscellaneous other taxes: Forty-eight states used estate and inheritance taxes (often referred to together as "death" taxes) and gift taxes to raise more than $346-million. Twenty-eight states raised $391-million from severance taxes. These are levies on the extraction of natural resources like

iron ore. Fourteen states imposed taxes on various documents and stock transfers to raise $103-million, and ten states raised $9-million by a poll tax on the right to vote.

The relative importance of each kind of tax varies from state to state. Summarizing the 1959 fiscal year, state governments collected about $15.8-billion in taxes -- about six per cent more than in fiscal 1958 and about twice as much as in fiscal 1950. The producer of the largest quantity of revenue (about one-fourth of all state tax revenues) came from general sales and gross receipts taxes although 16 states did not use them. Selective sales taxes on motor fuels were the second largest producers raising slightly more than $3-billion. Third came taxes on the incomes of persons and corporations with $2.7-billion. Selective sales taxes on items other than motor fuels were fourth with $2.5-billion. License revenues amounted to $2.3-billion, and miscellaneous other taxes (including property, inheritance and gift taxes, severance taxes, etc.) came to almost $1.5-billion.

Trends: Leon Rothenberg, Research Director of the Federation of Tax Administrators, summarized recent trends in state taxation in The Book of the States (1960). Governors of almost two-thirds of the states asked their legislatures in 1959 for tax raises. Rothenberg found that all of the legislatures responded by increasing state taxes. Rothenberg attributed the raises to "continuous pressures of population growth, and rising costs on education, highway, and welfare needs." Legislatures usually did not impose new taxes but preferred to increase the rates of existing ones. They also tended to raise rates on a group of taxes instead of on one broadly based tax, making "extensive use" of raises in the rates of taxation of alcoholic beverages and tobacco products, for example. Six states adopted income tax withholding of "pay-as-you-go." Six raised corporation income taxes; five boosted general sales tax rates, and nine states revised severance tax schedules.

This in a sense also summarizes Minnesota's 1959 experience. Asked by Governor Freeman for increased taxation, the legislature tended to raise rates of existing taxes; refused to enact income tax withholding; raised rates on groups of taxes, rather than a single one and made extensive use of tax increases on alcoholic beverages and tobacco products. By autumn of 1960 the candidates for governor were pointing to the need for raising more money, not promising tax cuts in 1961.

COMPARISONS OF STATE TAXATION

When people talk about taxes, they seem usually to be interested in discovering whether or not their own tax burdens are too high, too low, or just about right. They find that figures on national aggregates do not help answer their questions. Thus discussions of state tax levels tend to move to comparisons.

You may compare state taxes in a number of ways -- statutory tax rates, tax collections per capita, or the ratio of state taxes to some other index figure, average personal income, for example. Each method of comparison can be deceptive as the following discussion may suggest.

Statutory Tax Rates: The statutory tax rate is the percent or amount of tax set by law upon whatever is to be taxed. We might compare the percentages which state laws levy upon personal incomes in Minnesota and other states using the personal income tax. As of January 1, 1960, Minnesota's rates ranged from one to 10.5 per cent with 11 steps in the range. Mississippi, for example, taxed at rates ranging from two to six per cent. But there are important differences modifying these rates. Mississippi has only five steps in its range and gives a single person a $4,000 personal exemption, but it does not allow deduction of the federal income tax payment. Minnesota had an additional 10 per cent surtax and granted tax credits rather than personal exemptions, but it also allowed deduction of the federal income tax payment. Mississippi granted less relief to married taxpayers and no exemptions for dependents besides the wife. We are unable at this point, then, to say from the statutory rate whether or not a particular person's income tax would be higher in one state than another.

Other factors as well make statutory rates poor indicators of whether a specific person would pay higher or lower taxes in State "A" than in State "B". These include detailed provisions of state tax laws as well as quality of enforcement. These vary widely from state to state.

<u>State Tax Collections per capita</u>: Because of the foregoing limitations of comparing statutory tax rates, people sometimes compare states on a <u>per capita</u> basis. This method obtains a figure of the taxes each individual in the state would pay if every individual paid the same tax bill. You discover this by dividing the tax collections by the total population of the state. Thus, in fiscal 1959 the Bureau of the Census computed that state taxes of $90.29 per capita were collected in the United States. Deleware's $149.47 was the highest. At the other extreme was New Jersey with $56.71. Minnesota's $92.29 was two dollars higher than the national average with the state ranking 22nd in per capita tax revenues.

The Minnesota Governor's Tax Study Committee report of 1956 pointed to major reasons why this statistic also can be misleading or deceptive.[2.] It is merely an average figure produced by dividing total receipts by population. It does not tell anything about the tax cost of doing business in a particular locality. It provides no indication of what proportions of taxes are borne by particular persons or groups of persons. In addition, it tells us nothing about ability to pay -- that is, whether the amount is a relatively large or small share of the economic wealth of the taxpayers. Finally, it fails to indicate what the normal or typical tax bill might be because this will depend upon how the tax load is distributed among persons and business firms.

High per capita averages do not always accompany high total tax collections. In total collections, California's $1.8-billion and New York's $1.5-billion led the states. But in a rank order of per capita tax payments California stood sixth and New York 18th. Alaska, lowest in collections with $24-million, was eighth in per capita taxation. Because of these and other questions not met by per capita figures, other bases of comparison are often sought.

Tax vs. Index Comparisons: We frequently find comparisons of the states on grounds of how much of people's personal incomes are taken by taxes. Here, the tax is compared to some index or statistic purporting to describe personal

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2. Report of the Governor's Minnesota Tax Study Committee. (Minneapolis: The Colwell Press, Inc., 1956), pg. 115. This is a comprehensive and weighed analysis by a bi-partisan group with a highly competent staff. It is the most useful presentation of detailed analytical, historical, and comparative information on taxation in the state. This memorandum cannot begin even to summarize the full report but has drawn upon it heavily, often merely digesting and bringing some of its materials up to 1960. Besides the full report, including staff research reports, cited above, a 90-page excerpting of the material was published by Colwell Press without a date. It includes the summary of findings and conclusions and the conclusions and recommendations of the whole committee.

income. As in the case of per capita comparison, we run into problems because we are usually dealing with "fictions." We divide the total personal incomes reported in a state by the population of the state and get an "average personal income." But since a large fraction of the people of the state are housewives, children, and others who are not self-supporting, the average figure becomes less than entirely descriptive of the "typical" or "average" taxpayer.

With this warning, we may compute from data of the Bureau of the Census that state tax revenues in fiscal 1959 were about 4.5 per cent of average personal income for calendar 1958.[3.] On the whole, the higher the average personal income in the state, the higher also the per capita state tax revenues, but this is less than a perfect correlation. For example, Delaware, which collected $149.47 per capita to lead states in per capita taxation, had average personal income of $2,760 -- the second highest among the states. Delaware's per capita tax collections were 5.4 per cent of average personal income. Minnesota's $92.29 per capita taxation was 22nd. Its average $1,916 income ranked 23rd. The resulting ratio of 4.82 per cent was 29th in the nation.

At the same time a statistic like this does not tell us whether the tax burden falls more heavily upon the poor than the middle and wealthier taxpayers or the tax structure discourages movement of industry into the state. At best we are simply able to understand how men can be led to honest disagreements about comparative tax burdens growing out of conclusions based on different ways of comparing.

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3. Data taken from <u>Compendium of State Governmental Finances in 1959</u>, cited above.

<u>Impact of Taxes</u>: The 1956 Minnesota Governor's Tax Study Committee said that another and often more relevant way to gauge the impact of state taxes upon taxpayers would be to ask, "How much do these taxes <u>add</u> to my <u>total</u> tax bill, federal, state, and local?" It explained that most taxpayers can deduct their state and local taxes when they calculate their federal income tax, so the apparent dollar amount of the state or local tax payment becomes less important. For this reason, the Committee examined the "marginal effective state rate" -- the per cent by which state taxes actually increased a taxpayer's total tax bill. Using this device, it looked at the taxes a single person in the lowest Minnesota tax bracket would pay via the state income tax. The statutory rate for his bracket in 1955 (the year the Committee Staff made its calculations) was 1.1 percent. But after the taxpayer had deducted his state income tax payment when computing his U.S. income tax, he would have actually increased his total income tax payment by only .71 per cent. A single person earning more than $20,000 and subject to Minnesota's maximum statutory income tax rate of 11 per cent at the time would find that his total tax bill actually went up only 2.27 per cent because of the state income tax.

A critical question in examining state taxation then becomes one of determining the impact of a tax or set of taxes. It might be phrased as, "In practice, just what does this rate or tax do to a specific level or category of taxpayers?" This still is no criterion which automatically indicates whether taxes are too high or too low. Actually, there is no touchstone or formula to discover this. At best we are forced to move to an intensive scrutiny of the effects of particular taxes or tax structures. These effects differ from citizen and group to group. Nevertheless, a variety of criteria have been used to evaluate these effects.

CRITERIA FOR EVALUATING TAXES AND TAX STRUCTURES

A commonly used set of criteria for examining particular taxes was set out in Adam Smith's The Wealth of Nations in 1776. These tend to be used in some measure to date. Smith said that a tax ought to be:

a. Equitable — it ought to fall upon individuals in proportion to their ability to pay.

b. Certain — to guard against arbitrariness of those in power, the way of reckoning tax liability ought to be such that the taxpayer can arrive at his lawful tax accurately.

c. Convenient — that is, it ought to be levied at the times when the taxpayer is best prepared to pay it.

d. Economical — so that it is inexpensive to collect and administer.

Additional criteria have been added. First, the tax should be adequate to support the functions of government. Second, since a variety of different taxes are levied by each state, there ought to be reasonable justification of the way in which burdens are distributed among persons and among business firms. Third, because each state has a tax structure of a variety of taxes, the legislator must try to insure that characteristics of one tax do not have an undesirable effect of characteristics of another.

Political disputes over taxation often arise out of applications of these criteria (often by people who have not set out their criteria in an ordered way). Because we have lived in a period of hot and cold wars, we find that most people do not object to taxes high enough to support government. Rather, most disputes are currently about how the tax burden is to be distributed. The question is not "should we pay," but rather "who is to pay and in what proportion?"

Political conflicts tend to occur when one group of taxpayers decides that it bears a disproportionate share of tax burdens and tries to shift part of the burden to others. Minnesota in 1960 was the scene of a contest over adoption of a general sales tax. Opponents of the tax claimed that it was a device to shift tax burdens from businessmen to working people. Proponents felt that a general sales tax was necessary in order to provide relief from the property tax, which they believed to bear unjustifiably upon business and industry.

Political Disputes and Tax Impacts: As tax controversies have become increasingly acute in Minnesota, the Democratic-Farmer-Labor party has reaffirmed its belief that the graduated income tax best meets the criteria of tax appropriateness. Influential Republicans have argued for a general sales tax.

Advocates of the former as the main source of public revenues point to the fact that it is both equitable and certain. What one pays is determined by the economic goods he receives, and the precise sum of an individual's liability can be calculated with relative ease. Governor Freeman and the D-F-L have additionally argued for withholding of state individual income taxes or a "pay-as-you-go" plan so that the tax will be convenient, paid at the time the individual receives the income which is taxed. Finally, the tax has the reputation of being economical to administer and collect.

The equity argument is based on the feature of progressiveness. Most people take for granted that one's taxes should be in proportion to his ability to pay. They assume that taxes ought to take less of the poor man's penny than the rich man's dollar. Though the poor man pay only $25 in taxes, this represents a suit of clothes -- cheap to be sure, but all that he can afford. If the rich man pays $250, it is thought that he still will eat well, dress well, and be comfortably housed.

There probably is not much argument that state and local taxes are regressive. For example, Sen. Paul Douglas sought to demonstrate this to a senate committee in 1956, pointing to the great dependence of state governments on consumption and property taxes. In 1960, the Tax Foundation, Inc. also acknowledged the regressive character of state and local tax structures -- an instance of agreement between so-called "liberal" and "conservative" sources. The Tax Foundation was examining the way in which tax burdens in the United States are distributed among income classes. It concluded that the combination of national, state, and local taxes showed that people in the country pay taxes approximately proportional to their incomes. But their data revealed that the exact opposite was true when state and local taxes were examined.[4.] The higher the income, the lower the percent going to state and local taxes. The major reason, again: dependence of state and local governments upon consumption and property taxes. The Foundation, however, argued that the regressiveness was in some degree justified by the belief that taxation should be borne on the grounds of benefits received rather than ability to pay.

Advocates of a general sales tax in Minnesota have said that it is incorrect to argue that such a tax is automatically regressive. They point to a portion of the 1956 Governor's Tax Study Report which outlined how this could be avoided by exemption of some items or by a credit on individual income tax payments. Some also have noted that the Governor's budget recommendations depended heavily in 1959 on selective sales taxes -- principally

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4. The Tax Foundation Inc., <u>Allocation of the Tax Burden by Income Class</u>, (New York: May 1960), pg. 13. "On the other hand, the total state and local tax burden falls from 11.3 per cent for families with incomes under $2,000 to 5.9 percent for families with incomes of $15,000 and over. . . .The major part of these taxes are accounted for by excise and sales taxes and by property taxes." See also Table 10, "Taxes as a Percentage of Total Income By Source and Income Class," pg. 17.

upon alcoholic beverages and tobacco products — which are regressive.

In this debate, as in such debates in most of the states, it may be noted than an underlying issue involves shifting of tax burden. Less seldom heard are some arguments against major dependence of a unity of government upon an income tax. Among these are sensitivity of the tax to business cycles. In periods of economic recession when demand for certain public services rises, the revenue from income taxes falls. Another is that of John Kenneth Galbraith, the Harvard economist upon whom John Kennedy was said to lean for economic advice in his presidential campaign. Galbraith claims that in an "affluent society," men cling to ideas more designed for a society of scarcity. They spend an inordinate amount to create unnecessary wants for private consumption. At the same time, they refuse to vote bond issues needed for schools, tax raises needed for slum clearance, and other public consumption. Among Galbraith's suggestions is that private consumption be taxed via a kind of sales tax in order to finance needed public expenditures. Here is in effect an argument that in an affluent society, ability to pay be measured by private consumption as well as private income.

In summary, it may be said that taxes are a perennial source of political disagreements. Some political scientists, at least, would argue that this is natural and expectable. The Governor's Tax Study Committee report pointed out specifically that there is no non-political way of taxing:

> ... The distribution of tax payments among persons and business concerns necessarily differs from the distribution of expenditure benefits. Consequently, while a high level of expenditures and taxation is advantageous to some, the choice of high levels of ... (both) imposes not burdens on others. Unfortunately, that level which is 'best' for the people of the state as a whole is indeterminate. It is, however, only against a background of information with respect to public expenditures that tax policy in the broad sense can be viewed intelligently.[5]

5. Report, pg. 75

The benefit formula, which argues that people's taxes ought to be in proportion to the benefits received by them from government, falls short because there is no way of discerning or accounting for benefits from a variety of functions. Who benefits most from the public high school, the students, their parents, or the employers of high school graduates who are supplied with a pool of at least partially trained labor? We have no way to measure this. Who benefits more from social services -- the people who form the social worker's clientele, or the comfortable middle class which cannot be secure if it lives along side a restless, povertystricken mass of the poor?

Taxation -- put bluntly --is often a device for taking from those who have in order to meet the needs or demands of those who have not. Sometimes it is a way to force people to support the needs of the future which they do not see. Under such circumstances, it is to be expected that tax policies will be formed in the heat of conflict and represent sometimes uneasy compromises between antagonistic interest groups. While a "scientific" and non-political way of working out tax policies might be wished for, such a development remains for the future. We do not have it now.

Minnesota displays certain of these aspects of taxation. For example, the statutes of Minnesota contain two general provisions to protect the dairy industry. First, the sale of colored oleomargarine is prohibited. Second, a tax is placed on oleomargarine to reduce its price advantage over butter. Other states have similar kinds of provisions. Fourteen states, most of them in a movement which reached its highest popularity in the Thirties, imposed taxes on "chain stores" to protect neighborhood grocers, druggists, and other retail merchants.

Tax structures, therefore, represent a variety of motives and have a number of effects. They are the products of political struggles and the sources of political disputes. They may be regarded by economists as economic applications, by administrators as policy decisions, and by taxpayers as "good" or "bad." But elected executives and legislators look at the subject of taxation as an area of political struggle.

THE GENERAL PICTURE OF MINNESOTA REVENUES

Constitutional limitations: Subject to the limitations imposed by the U.S. Constitution (see Appendix One), state governments have authority to tax in any way which their state constitutions do not forbid. The Minnesota state constitution places a variety of limitations upon the taxing power of state government.

Article II, Sec. 3 forbids taxation of lands belonging to the United States and prohibits taxation of land of non-resident owners at rates higher than imposed on resident land owners. Sec. 10 of the same article forbids anyone to require a peddler's license for persons selling their own farm or garden produce. Article IV, Sec. 32 provides that railroads shall pay a gross earnings tax in lieu of other taxes on their properties in the state. It further requires that changes in railroad taxation must be approved by a majority of the voters in a statewide election. Article IX, Sec. 1 exempts a variety of institutions from property taxation. It also provides a household exemption from property taxation. Article XVI, Sec. 5 dedicates the use of taxes on automobile registrations and motor vehicle fuel to a special fund for highway, road, and street construction and maintenance.

The state debt limitation provision of Article IX, Sec. 5, deserves to be quoted at some length.

> Sec. 5 For the purpose of defraying extraordinary expenditures, the state may contract public debts, but such debts shall never, in the aggregate, exceed two hundred and fifty thousand dollars; every such debt shall be authorized by law, for some single object, to be distinctly specified therein: ...

Although this provision seems to place a clear and (to the layman, at least) unequivocal constitutional limit of $250-thousand on the entire debt of the state of Minnesota, state debt was more than $178-million at the end of fiscal 1959. During the fiscal year, the state had borrowed about $88.5-million while paying off almost $43-million of previous borrowing. Each time state legislatures had authorized bond issues in excess of the limit, the state supreme court had ruled in "friendly suits" that the issue did not actually contradict Article IX, Sec. 5. But in its latest decision, the court warned that it might no longer be so indulgent in its interpretations.

Tax Administration: Within limits set by the state constitution, the legislature makes tax policies. The state Department of Taxation bears the major share of responsibility for administering tax laws. There are exceptions to this. Major exceptions include collection of motor vehicle and a variety of other license fees by the Secretary of State; collection of liquor excise taxes by the Department of Liquor Control; determination of the state mill rate for property taxation by the State Auditor, and collection of property taxes by the county auditors of the 87 counties.

The Department of Taxation directly administers the individual and corporation income taxes; bank excise tax; gasoline tax; cigarette and tobacco products taxes; inheritance and gift taxes; iron ore occupation and royalty taxes:

gross earnings taxes on railroads, express, freight line, sleeping car, and telephone and telegraph companies; airflight property tax; vessel tonnage tax, and certain ad valorem taxes on public utilities. Tax monies when collected go to the State Treasurer who receives, accounts for, and acts as custodian for them.

Each session of the legislature brings a variety of suggestions and requested changes of tax rates, tax structure, and administrative arrangements. Many of these come from the Department of Taxation itself because it has the responsibility for proposing legislation to improve tax laws. Although the state constitution requires that tax bills originate in the House of Representatives, the State Senate has a standing committee on taxes and tax laws. This committee may amend House tax measures so drastically that they become for all purposes laws originated by the Senate.

Tax legislation in Minnesota for almost a decade has been a source of great difficulty. For example, the regular 1959 legislative session produced a Senate and a House approach to taxation. Conference committee members were unable to compromise the differences during the regular session, so a special "overtime" session had to be called. Then conference committee members continued to "deadlock" on major tax bills, so that new conferees had to be appointed. This kind of friction has been more intense since the Liberal faction won control of the House in the 1955 session. But even before the two chambers were controlled by opposing factions, news accounts indicate that tax disputes between the houses became bitter.

Dedicated Receipts: One additional general tax problem should be mentioned. Most states face financial difficulties because their constitutions and statutes dedicate or "earmark" a variety of tax revenues. This is in some measure the outgrowth of a "benefit" theory mentioned earlier -- the belief that there ought to be a close relationship between the amount a taxpayer pays in a tax and the benefit he receives from services financed by the tax. Additionally, to make imposition of new taxes more politically palatable, state legislatures have often dedicated the revenues to whatever function made the new tax necessary. This led in Minnesota to Constitutional provisions which dedicate monies from the iron ore occupation tax, the gasoline, and the motor vehicle license taxes. Statutes dedicate all or most of the revenues from income taxes, hunting and fishing licenses, and so on.

The Minnesota Legislative Manual for 1957-8 indicated that 77 per cent of the income of the state government for the fiscal year ending June 30, 1957, was dedicated. This meant that the state constitution or statutes dictated how three-quarters of the money taken in by the state government would have to be spent. For example almost 95 per cent of income tax receipts; 71 per cent of property tax receipts; 31 per cent of liquor tax receipts, and 23 per cent of cigarette tax receipts had already been set aside for specified purposes by the constitution or previous legislatures. This arrangement, while tending to give stable and predictable support to some activities of state government, makes it hard for a legislature to manage the public business. It cannot cut particular tax rates without automatically cutting some functions more than others. For example the legislature would cut school funds more than other functions if it lowered the income tax. Most income tax revenue is dedicated to support of public schools. In addition, the legislature cannot automatically obtain added funds to finance a new service by raising just any tax. Rather, it must either alter the formula dedicating a particular revenue (which is certain to create a political storm), increase a tax whose revenues are not dedicated, or impose a new tax.

Students of state taxation have said that the proportion of dedicated receipts ought to be reduced so that executives and legislators might manage finances more realistically. At the same time, every dedicated fund has at least potential support from some interest group (Example: Income Tax School Fund supported by Parent-Teacher Associations) when proposals are made to eliminate the dedication.

The remainder of this memorandum will examine some of the major taxes levied by the Minnesota state government. It will try to avoid repeating material in the 1956 Report of the Governor's Minnesota Tax Committee, rather seeking to supplement the briefer version of the Report. Much of its material has been based upon the staff research reports of the Committee.

TABLE 2. Minnesota's General Revenue and Taxes in Fiscal 1959[6]. (thousands of dollars)

	Minnesota		All States	
Taxes	$313,678		$15,848,480	
Intergovernmental				
From U. S. Government	129,075		5,887,522	
From local governments	12,852		364,371	
Total intergovernmental		141,927		6,251,893
Charges and Misc.	68,185		2,347,920	
Total General Revenue	$533,790		$24,448,923	

Fiscal 1959 Tax Revenues by Type

	Minnesota	Est. Per Capita	Pct. of Total Tax Revenues*
Selective Sales & Gross earnings	$114,011	$33.79*	36.7
Individual Income Taxes	76,504	22.51	24.3
Licenses	50,231	14.59*	15.9
Corporation net income	26,072	7.67	8.2
Property taxes	20,010	5.74*	6.3
Severance	19,537	5.55*	6.1
Death and Gift	7,092	1.95*	2.2
Document and Stock transfer	221	.49*	.06
Totals	$313,678	$92.29	

6. Data: Bureau of the Census, op cit, Tables 4,5, 36; pp. 10,11,49.
* Computed by formula from tax revenue amounts and per capita totals so that columns may not total owing to rounding-off error.

THE PROPERTY TAX AND ITS PROBLEMS

This tax, while forming only about six per cent of the revenue of the state government, produces in 1960 about nine-tenths of the tax collections of cities and villages and more than 95 per cent of the tax revenues of townships and counties. It was the only tax revenue source for special and school districts. This was a change from 1903 when state government got about half of its tax revenues from the property tax. Hard-pressed local units continue to urge the legislature to free a greater share of property tax revenues for local use. The property tax revenues of state and local units combined totalled $101.42 per capita in fiscal 1958 according to the Bureau of the Census, considerably higher than the national average of $81.07 for all states in the continental United States[7]. The Governor's Tax Study Committee in 1954 had found Minnesota's total also to be above the national average.

The property tax in Minnesota reaches to both real and personal property. But over many years, legislatures have granted special treatment to various kinds and classes of property, so that by 1960 there were 13 classes of general property, each eventually taxed at a different rate. In addition to these 13, there were various kinds which were not taxable as property at all. Figures I and II adapted from the report of the Governor's Tax Study Committee staff report summarize this.

This complicated arrangement must be administered. Students of Minnesota taxation have argued that most of the time and energy devoted to tax administration in the state goes to administration of the property tax. Property tax administration typically must allow for a number of steps -- assessment, review, equalization, collection, and appeal.

Assessment: In order to tax an item of property, the taxing authority first must find it. Next, it must list and set a value on the item for taxing purposes. Here is where complicated classifications multiply difficulties,

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7. Bureau of the Census, Governmental Finances in 1958 (G-GF58-No.2) Table 14, pg. 4.

FIGURE I - PROPERTY TAX EXEMPTIONS*

The property tax extends to real and personal property except that which is exempted by law. The following kinds of property are not taxable (as of 1960).

1. Public property - property owned by the United States government is exempt from taxation except that which Congress has otherwise provided may be taxed by states. Most of the property of the U.S. thus is exempt. In the same category falls property owned by the state and local units of government which is used for a public purpose.

2. Property used for education, religion, and charity - Minnesota usually exempts from property taxation the property of organizations devoted to charitable, religious, and educational purposes and used for these purposes. Property used for public charity is tax exempt, and "academies and seminaries of learning" may be tax exempt even if operated for a profit although such organizations as barber colleges and riding schools do not qualify as "seminaries of learning."

3. Property otherwise taxed - railroads, telephone, telegraph, freight line, sleeping car, and express companies pay gross earnings taxes and need not pay property taxes on property used for operating purposes. Grain handlers pay a special tax on grain they handle and are exempt from ad valorem taxes on it. Cooperative light and power associations pay a per capita tax on their members and free their distribution lines in rural areas from property tax. The provisions of the bank excise and insurance premiums taxes free tangible personal property of banks and insurance companies used in the business from property taxation. Motor vehicles and trailers which are licensed for use on highways are not taxed as property, also watercraft which pay the registration tax authorized by the 1959 legislature pay this tax in lieu of property taxation.

4. Household goods - up to 1959 the personal property of every householder up to $400 of full and true value or $100 of assessed value was exempted. The 1959 legislature gave the counties the option of exempting all household goods from the state property tax levy or repealing the $400 exemption.

5. Intangibles - intangible property is not taxed, and the property tax applies only to land and improvements and tangible personal property.

6. Homesteads - the first $4,000 of the full and true value of a homestead is exempt from the regular state mill levy.

7. Taconite - special taxes on iron concentrates and a low tax on reserve properties from which less than 1,000 tons of concentrate per 40-acre tract is produced are collected in lieu of other taxes on machinery, equipment, and other facilities used in mining and concentration of taconite.

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* -- condensed and adapted from the Report of the Governor's Tax Study Committee, pp. 141-2.

FIGURE II*

Class	Description	Per cent of "full and true" value
	I. Personal Property	
1.	All mined iron ore in stockpile.	50
1A.	Direct products of blast and open hearth furnaces, not further processed	15
2.	Household goods and other personal property actually used for personal and domestic purposes or for the furnishing and equipment of the family residence.	25
3.	Business property, including stocks of merchandise together with the furniture and fixtures used therewith; manufacturers' materials and manufacturers' articles; all agricultural products not in the hands of the producer; all tools and implements; and all machinery not permanently attached to, and a part of the real estate, except agricultural products in the hands of the producer and farm tools and implements and machinery used by the owner in any agricultural pursuit.	33 1/3
3A.	All agricultural products in the hands of the producer. .	10
3D.	All livestock and poultry and all agricultural tools, implements and machinery used by the owner in any agricultural pursuit.	20
4.	Structures on railway land not owned by railroads; private property on urban public lands; water craft; transmission and distribution systems of utility and pipeline companies; billboards and other advertising devices; and other taxable personality.	40
None given	Electric distribution lines, for sale of electricity to farmers at retail.	5
	Other rural electric transmission lines.	33 1/3
	Personal property of petroleum refineries.	17
	II. Real Property	
1.	Unmined iron ore.	50
1A.	"Low grade" iron ore, with "tonnage recovery" below 50 per cent, maximum rate of assessment to decrease $1\frac{1}{2}$ per cent for each 1 per cent decrease in "tonnage recovery" (ratio of weight of post-beneficiation concentrate to the weight of low grade ore), up to a minimum.	$48\frac{1}{2}$ to 30
3.	Non-homestead real estate which is rural in character, devoted or adaptable to rural but not necessarily agricultural use.	33 1/3
3B.	First $4,000 of "true and full" value of rural homesteads	20
3C.	First $4,000 of "true and full" value of urban homesteads	25
3CC.	First $8,000 of "true and full" value of all real estate with special fixtures adapted for occupancy by permanently disabled veterans.	5
4.	Urban real estate and urban homesteads on "true and full" value above $4,000, urban homesteads of totally disabled veterans above $8,000.	40
None given	Real property of petroleum refineries.	27

* — From Report of the Governor's Tax Study Committee, pg. 147

but there are additional problems. Even after the assessor has located some item of property (usually by hunting for it), listed, and classified it, he must compute the amount of tax to be levied on it. This computation requires that he first establish its market value -- the price at which it presumably would sell under ordinary and not forced-sale conditions. From this, he computes the full and true value. The Governor's Committee Report noted that this is legally "defined as market value, but in practice. . . is only a fraction of current market value."[8] He multiplies the full and true value by the proportion set for the classification of items by law and obtains its assessed value. Minnesota allows reduction of this by deduction of a so-called "household exemption" in order to arrive at the taxable value. The taxable value is the amount to which the tax rate is applied. The total "tax base" for this tax then becomes the statewide total of taxable values.

A major problem raised by the property tax is that in Minnesota as in most states the property tax base has become far smaller than the total estimated market value of property in the state. Although in the first half of the Twentieth Century, the market value of property in Minnesota climbed steadily, total taxable values went down. It appeared that full and true values set by assessors were a steadily falling fraction of actual market value. But there were other reasons why the property tax base did not equal the total market value of property in the state. First, a great deal of property was exempted from property taxation. Then, the classification system took away about two-thirds of the remaining values. This eventually made the real property tax base

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8. Report, pg. 148.

less than a third and the personal property base less than a fourth of full and true values. But the Governor's Committee, for example, came to the conclusion that the problem of tax base erosion was in a significant way traceable to faulty assessment.

Review and Equalization. This kind of circumstance led by the Forties to emphasis on additional steps in property taxation, review and equalization. The legislature provided that counties might hire trained supervisors of assessment. In each locality, some body -- the town board in townships, the governing body of villages and cities, or in the larger communities was directed to act as a "board of equalization" -- carrying out the job of reviewing assessments. The boards can add omitted property to the rolls. Either upon complaint of a taxpayer or upon their own initiative, they can correct assessments (although they cannot raise an assessment until they have notified the property holder and granted him opportunity for a hearing). These boards are required to conduct the review function and meet between June 1 and July 15 on a date set by the county assessor or supervisor of assessment. Some are said to do their work faithfully while others do little or nothing.

Statutes also provided for an equalization function having a variety of purposes. The purposes of equalization include:

1 -- seeing that county taxes are equally levied among assessment districts within each county and that state taxes are equally levied among the counties.

2 -- insuring that the tax burden is equal upon property assessed locally and the various kinds of special property assessed by the State Commissioner of Taxation.

3 -- offsetting conscious or unconscious tendencies of assessors to discriminate against some classes of property.

4 -- seeing to equalization of the apportionment of state aid funds when these are distributed on some basis which includes assessed values.

There are other purposes of "equalization," but these are among the more important. The county board of equalization in Minnesota counties, is made up of a majority of the county commissioners and the county auditor. It meets on the third Monday of July. It can change the valuation of all property of a given class in the county or in any local assessment district of the county. But it cannot reduce the aggregate assessed value of real or personal property in the county.

State Board of Equalization. When the Department of Taxation was created in 1939, the legislature assigned the function of acting as a state board of equalization to the Commissioner of Taxation. Besides the task of equalization among the counties, he also can perform equalization within a county. But he may not reduce the aggregate valuation of property in the state by more than one per cent in any year. To perform his function, he can raise or lower the assessment of individual pieces of property if this will help equalize values. Or he may add to or deduct from the value of any class of property of any county, city, village, or town. For a number of years, the State Board has sought to correct a variety of shortcomings in assessment work, but the Governor's Tax Study Committee said that its staff was too small and pay levels were too low to fill authorized technical positions.

Examples of Problems: (1) Assessment Date -- By law, property is assessed according to its ownership May 1. On this date coal dealers have very low inventories, but boat dealers are loaded up. Since business inventories fall into the personal property tax, some businessmen are hit hard and others escape. Farmers also have problems. Cattle feeders in Minnesota produce short-fed or long-fed beef animals. They buy animals in the fall, and the short-feeder markets his after fattening them three or four months. Thus on May 1, he probably will have empty feed lots and escape paying property tax on the animals he has fattened. The long feeder, however, keeps animals in the feeding pans from four to six months to produce a heavier animal. These feeders usually have a large inventory of beef animals in their lots at about the peak of their value.

The May 1 assessment date seems to have the effect of allowing much property to escape taxation and to penalize those who are unable (because of the character of the property) to escape. A variety of businessmen deliberately seek to have little if any inventories on that date. An admittedly extreme example was discovered by the State Department of Taxation in research on the impact of the May 1 assessment date. A wholesale grocery firm reported an inventory value on December 31 of $182,000 for income tax purposes, but it had a full and true inventory value on May 1 for property tax purposes of only $15,900. A drygoods store had inventories of about $80,000 in December but a full and true inventory value of $114,000 on May 1. Anomalies like these led the Governor's Tax Study Committee to recommend assessment of real and tangible personal property as of January 1 while taxable inventories (except iron ore) would be assessed on the average monthly inventory for the calendar year.

Examples of Problems: (2) Assessment -- The staff report of the Governor's Committee called assessment the greatest weakness of the property tax. It said:

> Assessors who are unqualified or unwilling to do their job properly often do nothing except copy the last assessment roll. In some cases they do not even fully complete the evaluation cards. When local assessors do not do a satisfactory job, a county assessor can legally do the work himself or have it done by a deputy. . . .[9]

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9. Report, pg. 159

This was noted as a perennial problem by the Minnesota Institute of Governmental Research, Inc., in 1948. This group noted:

> The problem of inadequate local assessments has been called to the attention of the legislature for over a quarter of a century by every survey of the Minnesota tax system.[10]

Minnesota has about 2,700 people assessing property. Most of them are part-time, untrained people -- hired often because they are the only persons who will take the low-paid job. County assessors or even professionally-trained county supervisors of assessments in the counties using this system usually do not have the time or staff to correct work done badly by unqualified or unwilling assessors. Even conscientious assessors may lack the technical skill or knowledge of values to assess various kinds of property properly. The Governor's Study Committee urged improving the county assessor system to produce trained men working at salaries which would attract well-qualified personnel.

Examples of Problems: (3) Review: Suppose that you believe that your property assessment has been markedly higher than your neighbors', yours having been at full market value while theirs was at a much lower fraction. What can you do? Statutes provide a series of appeals -- to your local assessor, local board of review, county board of equalization, and to the State Tax Commissioner. Appeal from the Commissioner's ruling may be taken to a three-man Board of Tax Appeals, and from it to the State Supreme Court. But both the applicable laws and appeal procedures led the Governor's Committee staff point to a "widespread belief in Minnesota" that appeal methods were not simple, inexpensive, and certain enough to really protect the taxpayer.

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10. The Minnesota Institute of Governmental Research, Inc., The Minnesota Tax System, State Governmental Research Bulletin, (St. Paul:1948), pg. 28.

Recent legislatures have not yet been able to solve all of the problems of the property tax. Businessmen in 1960 continued to argue that the tax on personal property put Minnesota industries at a sharp disadvantage when competing in a national market. Their machinery, tools, raw materials, and inventories were assessed at 33 1/3 per cent of "full and true" value. This added to their costs. But to the extent that they were selling in a competitive national market, they often might be in danger of pricing their product higher than that of a non-Minnesota industry. They felt also that the classification schedules were discriminatory and penalized them.

On the discriminatory character of classification and rates the 1948 research bulletin of the Minnesota Institute of Governmental Research, Inc., commented:

> There is no question but that the classification system was devised and intended to discriminate against some types of property and favor others. Probably no one could justify the schedule, but it was drafted under the general scheme in mind to use 'ability to pay' as a measure of taxation, the assumption being that iron ore could stand the heaviest tax; the farmer's products the least. .....Probably it was assumed that business could absorb taxes as part of costs which would be passed on to the consumer if possible.
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> * * *
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> [Besides the charge that the tax discourages location of industry in Minnesota, it is said that] ... if influence the development and maintenance of inventories, both of raw materials and finished products and machinery. Such inventories are of major importance in providing steady employment, therefore, they should not be discouraged.[11]

<u>The 1959 Legislature</u>: Governor Freeman's budget message to the 1959 legislature called reform of the property tax "long overdue." He announced the long-term goal of reducing it, but he said that need for revenue forced

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11. <u>Op. cit.</u> pp. 41 and 42.

postponing cuts in the personal property tax burden of industry. Rather, he advanced a six-point program directed at improving the assessment and equalization functions. The 1959 legislature again made no move to repeal the personal property tax or replace it. It did, however, authorize counties to either exempt all household goods from the state property tax levy or to repeal the $400 exemption of household goods. It exempted grain in the hands of the producer and stored cheese which was in the process of aging. While lakeshore summer homes and properties other than commercial ones had been assessable previously at 40 per cent, the legislature lowered the assessment rate to 33 1/3 per cent by reclassifying them as agricultural lands. To assist local units, the legislature did not levy a property tax for general revenue fund purposes, thus giving the local units the opportunity of greater use of the property tax.

THE INDIVIDUAL INCOME TAX

This tax in fiscal 1959 produced about $76,504,000 in revenue for the state government, about $22.51 per capita or approximately one-fourth of the tax revenue of the state government. Minnesota's statutory rate was set at one to 10 per cent from the lowest (0-$500) bracket to 10½ per cent in the highest (over $20,000) bracket. A 10 per cent temporary surtax was continued. A surtax, simply put, is a tax upon a tax.

Governor Freeman, in his budget message to the 1959 legislature, proposed to get added revenue from the personal income tax by:

1 -- adopting a "pay as you go" or withholding method of payments, and...

2 -- raising rates one per cent on each bracket of taxable income above $500 and re-enacting the temporary 10-per cent surtax.

The state administration estimated that the changeover to withholding would also produce a "windfall" because taxpayers would in 1960 for example pay both 1959 taxes (which had not been withheld) and 1960 taxes by withholding. The Governor proposed to "forgive" half of the tax liability for the non-withheld year and to devote the other half to finance what he called "non-recurring" activities.

The majority group of the state senate doggedly refused to accept any withholding provision. After long deadlocks, primarily in a special session, the Governor's recommendations were set aside and the legislators raised all bracket rates above $500 by one-half of one per cent; raised the depencency credit from $10 to $14 (instead of the $10 to $15 recommended by the Governor); continued the 10 per cent surtax, and ignored withholding. By late 1960, the question of "withholding" was again a topic discussed by both Republican and Democratic nominees for the governorship. Both Governor Freeman and Sen. Elmer L. Andersen said that they favored the device. Results of the Minneapolis newspapers' accurate Minnesota Poll had suggested that a majority of adult citizens favored it. Who, then, did not?

Opponents of the device appeared to include at least two important segments. The first, representing some business classes, appeared to be best represented by the stand of the Minnesota Taxpayers Association. The other segment appeared to be made up of members of the more conservative faction of the Republican Party.

Arguments against the withholding or pay-as-you-go method of income tax collection, voiced by Charles P. Stone, general counsel of the Minnesota Taxpayers Association, have included objection to the "doubling-up" feature.

In the first calendar year of withholding, taxpayers would have paid both the previous and the current year's tax, thus two years are paid in one. The Association said that the cost of installing and collecting the tax would exceed the estimates of the Department of Taxation. It claimed that the majority of Minnesota's individual income taxpayers did not need withholding as a convenience, and it minimized the argument that the device would increase the number of taxpayers by eliminating much evasion.

An argument, also repeated by some Conservative members of the state senate, was that withholding "invites a steady inching upward of our state income taxes, either by way of increased rates or in the form of additional surtaxes." This claim would be difficult to substantiate but was intensely believed by some people.

The Governor's Tax Study Committee, on the other hand, recommended the device. The Committee argued that advantages of the withholding method outweighed its disadvantages. Other advocates of the change pointed to the existence of withholding of the U.S. income tax as minimizing employers' cost of collection of a state income tax. They cited the report of the Minnesota Poll of the Minneapolis newspapers that the device was thought desirable by a majority of a representative cross section of citizens of the state. Against claims of expensive administration, they pointed to estimates by Oregon and Kentucky that direct administrative costs of withholding were about $150,000 a year, while Colorado estimated only $53,000.

Viewed as a device to raise revenue only, the Governor's Committee also noted that the individual income tax in Minnesota produced a higher portion of state revenues than any other single tax. It added a degree of progressiveness to a state tax structure which otherwise would be markedly regressive. At the same time, the sensitivity of the tax to fluctuations in the business cycle makes its revenues drop at the times when state revenues are most needed.

THE CORPORATE INCOME TAX

In fiscal 1959 the net income of corporations was taxed by 36 states. Minnesota's statutory rate of 9.3 per cent on business corporations was second highest to Idaho's 9.5 per cent.[12.] At the same time, however, Minnesota and Idaho allowed deduction of the federal income tax, although most other states taxing corporation net income did not. Thus, in terms of actual impact, the marginal effective state tax rate could drop to about one-fourth of the statutory rate. The Governor's Tax Committee research staff reported that in 1955 Minnesota's statutory rate was second in the nation, but corporations' marginal effective state rates were only 18th.*

Minnesota in 1960 subjected national and state banks to a still higher statutory rate of 11.4 per cent. Banks were taxed at the higher rate because they had been exempted from the tax on tangible personal property, and the higher rate then was imposed in lieu of all other taxes except on real property. The banks were otherwise treated for tax purposes as any other business corporation.

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12. The Book of the States, Sec. V., Ch. 2, Table 2, pg. 210, recapitulates statutory rates on corporation net income. Both corporation and bank rates cited here include temporary rates of 1.8 and 1.9 per cent, respectively, imposed by the 1959 legislature.

* -- the marginal effective state tax rate, mentioned previously, is the percent added to the taxpayer's total national, state, and local tax bill by the state tax.

The Governor's Tax Study Committee found that Minnesota defined corporate net income in most respects like similar definitions by federal tax laws. There were several exceptions, each of which allowed the corporate taxpayer some considerable measure of relief from the high statutory rate.

First was the deductability of federal income tax from income, a feature usually not allowed by states with lower statutory rates.

The second, the "property-payroll credit", allowed the taxpayer to deduct up to one-tenth of the corporate income tax payment owed before imposition of surtaxes. This would be computed by arriving at the average percentage of the corporation payrolls and property which were located in Minnesota. Then one-tenth of this could be deducted from the corporate income tax before computation of surtaxes.

The third device is commonly used by states when taxing corporations doing business in several states. By it, each corporation is allowed to apportion its income subject to taxation among the several states in which it does business. Usually, the income is apportioned following a "three-factor formula" which averages the proportions of sales, tangible property, and payrolls in the state to total corporate sales, tangible property, and payrolls. But Minnesota offers corporate taxpayers additional tax-lowering options through an "alternative allocation formula" so that corporations which produce locally and sell outside the state, for example, can be benefitted. Although the latter options were incentives for location of industries in Minnesota, they cannot equal the complete absence of corporate income taxes offered by Illinois, Indiana, Michigan, and Ohio (to cite only other Midwestern states). The Governor's Committee staff report suggested that good public relations and good revenue planning would be served by eliminating the deductability of federal income tax payments but at the same time lowering the statutory rates. Governor Freeman's recommendation to do this in the 1959 legislature failed as did recommended changes in the "alternative allocation" formula.

TAXES ON IRON ORE AND TACONITE (SEVERANCE TAXES)

The United States of the 20th Century has been built, for the most part, out of Minnesota iron ore. The statement is not over-dramatic. If you examine figures on iron ore mined in the United States since 1900, you will discover that Minnesota has tended to account for most. But in the late 19th century, the mining industry was an infant, and the legislature tried to encourage it by substituting one cent per ton severance tax upon mined ore for the property tax. The arrangement continued until 1897 when the Minnesota Attorney General advised that the method was unconstitutional. Thus, the early severance tax was repealed.

By the turn of the century the industry had established itself, and taxation of iron ore became a political issue. Some people argued that foreign corporations were profitting too much by depleting an irreplaceable Minnesota resource. They urged taxation in ways which would extend the life of diminishing high grade resources and give a bigger share of the mining profit to government. Such arguments led the legislature in 1913 to set up the four classes of property subject to the property tax. Iron ore became class one, assessed at the highest rate -- 50 per cent of full and true value. By 1920 there was pressure for still greater taxation of iron mining. Governor Preuss campaigned for a "tonnage tax" on iron ore, so he asked the 1921 legislature to add a new net profits tax on iron ore mined in the state. The legislature imposed a six per cent tax on the value of all iron ore mined. To insure constitutionality of the tax it also proposed a constitutional amendment. This provided that an occupation tax on the value of all ores mined or produced could be added to all other taxes provided by law. The electorate ratified the amendment in 1922. The 1922 amendment also said how revenues from the tax were to be used. Fifty per cent was to go into in the General Revenue Fund, 40 per cent to the Permanent School Fund, and 10 per cent to the Permanent University Fund. A 1956 amendment maintained the same proportions but opened the way for use of the revenues to meet current needs. The structure of levies on the mining industry was substantially completed by the legislature of 1923. It imposed a six per cent tax on mining royalties. During the depression years, legislatures regularly boosted the rates.

But by the middle and late Forties, Minnesota ores began to face important competition. While Minnesota high-grade ores had dwindled, large high grade deposits were opened in Canada and Latin America. But at the same time, research had developed ways to extract iron from taconite, a lower-grade iron-bearing rock. The legislature as early as 1941 had begun to encourage development of low-grade ores and taconites by shifting taxation of them to a low severance tax on the concentrates produced. By 1955, the rate of taxation on taconite was five cents per gross ton of concentrate plus an additional tenth of a cent a ton for each percent of iron content over 55. Although this tax was in addition to occupation and royalty liabilities and the property tax levied on the surface value of taconite lands, it was in lieu of all other taxes on taconite mining, particularly the personal property tax on machinery, tools, and all other things used in the mining operation.

Minnesota thus in 1960 imposed three kinds of taxes on the mining industry, the ad valorem tax (or property tax) applied to iron ore whether in stock piles or in the ground; the occupation tax, and the royalty tax. At the same time, mining companies were not subject to the corporation net income tax. The Governor's Tax Study Committee staff commented that Minnesota taxation of iron ores and mining combined features of property, severance, and net income taxes. The structure was thought (from the standpoint of government) to combine in fair degree the major advantages of each type.

Method of taxation of a mining indsutry has political and technological effects. The Governor's Committee pointed to the underlying philosophical ambiguity in the statutory treatment of mining industries which generates great political heat.

> The mining enterprise is regarded as a private economic activity enjoying the rights of private property like any other business. At the same time, the mining realty (the mineral resource) is viewed by many as a "natural heritage" which "belongs" in some undefined way and to some uncertain degree, to all the citizens of the state.[13]

Minnesota tax treatment, particularly that which classifies iron ore so that it is assessed at the highest percentage of value of all kinds of property taxed, reflects a view that a large part of the value of the resource should go to public purposes. The differential treatment of taconites and other low-grade ores bespeaks an attempt to encourage private investment in recovery of low-grade rather than high-grade ores. These variations in taxation may also affect the way mining is conducted. The tax on ore as property gives government

13. Report, p. 325

a steadier level of income, but it also encourages fast and sometimes wasteful mining. Taxing on production, a severance tax, does not so much encourage "quick and dirty" mining, but its revenues will fluctuate widely with business cycles. A net income tax, even more than a severance tax, will tend to encourage thorough recovery of ores and use of lower-grade deposits. But the net income tax also collects little or nothing when a mine is closed by a strike or by business conditions.

The magnitude of receipts from occupation and royalty taxes on iron ore and taconites for the state government in the 1959-61 biennium was estimated by the Minnesota Taxpayers Association at more than $62-million dollars. This level was produced by action of the 1959 legislature in raising the occupation and royalty tax rates from 11 to 12 per cent together with temporary surtax impositions of 2.25 per cent. Governor Freeman had noted in his budget message "the impact of recession and foreign ores on the position of Minnesota iron ore" and urged continued low tax levels on taconite operations.

Future Prospects: Any discussion of Minnesota iron ore taxation hinges upon the role of iron ore taxation in the future. With the depletion of Class One "direct-shipping" ores, which can be shipped to blast furnaces without added treatment beyond crushing or screening, the industry ordinarily would turn to Class Two ores. These are lower grade than class one because they contain sand, other impurities, or moisture. These ores must be refined or concentrated by an appropriate process. These processes, however, involve higher amounts of labor, so while class two ores are reasonably abundant, they are more costly to produce. Class III or taconite ores are extremely low grade and require large investments in machinery for production.

There seems no great consensus about the tendency of tax burdens on ore mining to speed the decline in the Minnesota share of the iron ore consumed by the steel industry. Estimates obtained by the Governor's Tax Study Committee showed that competition of other sources by 1984 might make iron ore production of the Lake Superior area drop from 82-million to 25-million tons. But this was offset by anticipated yearly need for 42-million tons of taconite production by 1984. The net result would be about a 20 per cent decline in the Lake Superior industry, thus probably a corresponding decline in Minnesota. But the committee staff noted that such predictions relied on "conservative" estimates of the total national steel needs in 1984, estimates exceeded by predictions of a number of steel company executives.

It seemed apparent, however, that to encourage competitive uses of Minnesota taconite, the state might be forced in the future to reduce tax demands on the iron ore industry. Put briefly, the state might be forced to take a decreasing share of the revenues of the mining industry at the same time the revenues, themselves, might be falling. Also put briefly, in talking to Minnesotans it is possible to infer that iron mining companies still are regarded as "foreign" exploiters of a state resource who ought to be heavily taxed.

SELECTIVE SALES AND GROSS RECEIPTS TAXES

The Bureau of the Census classifies a variety of taxes levied in Minnesota as "selective sales and gross receipts taxes." Such taxes include those on motor vehicle fuel, alcoholic beverages, tobacco products, insurance premiums, and the like. They are called "selective" sales taxes to distinguish them from a "general" sales tax. This category also includes gross receipts and gross earnings taxes.

State legislatures find these taxes particularly useful because they provide a fairly stable source of revenue, are relatively easy to administer, can be collected without much pain to the taxpayer, and often can be justified by a convenient rationale. Under this category, we will look at the Gross Earnings Tax and the taxes on alcoholic beverages and tobacco products. The selective sales tax on motor vehicle fuels will be considered under another category, highway user taxes.

The Gross Earnings Tax

Minnesota taxes the gross earnings of certain businesses, primarily railroad, freight line, sleeping car, express, telephone, and telegraph companies. Most of the revenue from the tax comes from railroad and telephone companies. In 1900, railroads paid more than a million dollars under the gross earnings tax. In the years of World War Two, their payments exceeded $10-million. In fiscal 1954, they passed $14-million, and in fiscal 1959 they were $13-million. The revenue produced from railroads fluctuates widely depending upon business cycles. The Governor's Tax Study Committee found that in 1954, railroads paid a higher taxes under the gross earnings tax than were paid to Minnesota by the railroads' most serious economic competitors, the commercial motor freight carriers.

Railroads pay the gross earnings tax in lieu of all other taxes on operating property. The legislature originally imposed the tax by a constitutional amendment proposed in order to keep railroad companies from corrupting legislators in order to gain tax advantages. The amendment was adopted in 1871. The rate of the tax had increased to its present five-percent level by 1919. Now, the Constitutional requirement that changes in the tax must be approved by a referendum of the voters of the state is thought to give railroads a tax advantage, but this does not seem to have been its original purpose. The tax is levied on earnings from business beginning, ending, or going through the state. All earnings from intra-state business are taxed. Earnings from interstate business are taxed only in the proportion of the ratio of mileage of the railroad in Minnesota to its total mileage.

Telephone companies are required to pay the corporation net income tax as well as the gross earnings tax but are exempted from other taxes. The statutory rate is four per cent on earnings from rural areas and communities under 10,000 population. Gross earnings from all other business are taxed at seven per cent. In fiscal 1955, the telephone companies paid a little more than $5-million under the gross earnings tax. By fiscal 1959, their payments were in excess of $7.2-million. The Governor's Tax Study Committee research staff found that the share of gross earnings taxes paid by railroads declined from almost 83 per cent in 1945 to 68 per cent in 1955, most of the shift being to telephone companies. By fiscal 1959 the railroads' share had dropped still further to about 65 per cent.

The gross earnings tax is classified as a consumption tax because it tends to be shifted on to the consumer. This leads to the criticism that higher tax rates on urban telephone earnings than on rural or small town earnings means simply that urban telephone subscribers are taxed more heavily. Other criticisms of Minnesota's gross earnings tax arrangements have been made. Although the Governor's Tax Study Committee noted that railroads were perhaps more heavily taxed than motor freight carriers, it found no logical reason why railroads alone of gross earnings taxpayers ought to be exempted from the state corporation net income tax. Gross earnings taxes also are criticized for tending to exempt from local taxation the property of the companies which pay it. Past legislatures made provision to reimburse some school districts from the Income Tax School Fund for loss of local revenue where at least 20 per cent of local property was exempted from local taxation because property holders were taxed instead on gross earnings.

From a revenue standpoint, gross earnings taxes on other utilities were not deemed importantly large by the Governor's Tax Study Committee. It particularly studied the impact of the tax on railroads and found Minnesota taxation of railroad companies to be higher than other midwestern states and higher than the national average. It recommended a study of the feasibility of moving away from the gross earnings tax to the regular ad valorem property tax and corporate net income tax, particularly for railroads.

Alcoholic Beverage and Tobacco Product Taxes

Some persons still tend to regard these selective sales taxes as "sumptuary" taxes, those levied to encourage frugality and temperance. More important to legislators has been their ability to raise large revenues. Additionally, the legislature finds them easy to raise and easy to collect. Thus, in fiscal 1959 the state of Minnesota got $30,178,000 revenue from them -- more than it collected as its share of the property tax or from the corporation net income tax.

When the 1959 legislature hunted more tax revenues, it raised rates sharply on these. It had raised individual income tax rates one-half per cent for each bracket, but it boosted the permanent cigarette tax from four to 5-1/2 cents, more than 37 per cent. Taxes on beer went up about 45 per cent. So-called 3.2 beer was boosted from an effective $1.10 to $1.60 a barrel and "strong" beer from $2.20 to $3.20 a barrel.

The results are enlightening. Data compiled by the Minnesota State Taxpayers Association on estimated state government receipts for the 1959-61 biennium show several things. The data of the Association predict that in the biennium the General Revenue Fund -- which pays for most state activities except highways and education -- is expected to have about $220,863,000 in tax revenues. The legislature provided for this in several ways, first getting about $13.9-million by re-enacting temporary taxes, almost one-half of which ($5.6-million) would come from the tobacco products tax and liquor surtax. It raised about $13.9-million more by new financing. Of this $12.9-million (or about 93 per cent) was from raises in the cigarette tax, liquor surtax, tobacco products tax, and the beer tax. Thus about $59.8-million or almost 28 per cent of the estimated revenues for the General Revenue fund in the biennium would be raised by the alcoholic beverage and tobacco product taxes.

It seems apparent that revenue and not moral feeling about consumption of such products now recommends these taxes to legislatures. Most states show a like pattern. All 50 states levy taxes on alcoholic beverages and 45 of the 50 tax tobacco products. In fiscal 1959 selective sales or gross receipts taxes on alcoholic beverages in the 50 states totalled about $602-million. Forty-five states got $677-million from their selective sales taxes on tobacco products. This adds up to almost $1.3-billion.

The Governor's Tax Committee staff pointed to these taxes as regressive and discriminatory. Lower income groups tend to spend a greater share of their incomes on tobacco products and alcoholic beverages (particularly beer) than do higher income groups. It is discriminatory because the tax is imposed on the physical quantity sold rather than the value of the item. Thus, the buyer of a "fifth" of the cheapest liquor pays as much state tax as if he were buying the same quantity of the best.

Enforcement Problems: Alcoholic beverage taxes more than other selective sales taxes may produce special enforcement problems. "Moonshining" and "bootlegging" did not disappear with the repeal of the 18th Amendment. The heavy federal taxation of alcoholic beverages plus the state tax may encourage illegal manufacture. A state which taxes sale of these beverages at a sharply higher rate than its neighbors may encourage illegal imports from neighboring states by bootleggers. The data collected by the Governor's Tax Study Committee suggests that except for 3.2 beer, Minnesota taxes tend to be higher than most neighboring states. However, it is not certain how much illicit manufacture and sale have been produced although the incentives might be considerable.

Other Revenues from These Sources: Besides the revenues going into the General Revenue Fund from selective sales taxes on tobacco products and alcoholic beverages, other taxation of these items should be mentioned. Minnesota and most other states impose license fees upon manufacturers, wholesalers, distributors, importers, retail sellers, and common carriers of alcoholic beverages. Local units of government also may require licenses of sellers of such products. Finally, Minnesota laws allow villages and cities of the fourth class a "local option" in the way alcoholic beverages are sold. At its option the community may operate a local retail sales monopoly or license private retail sellers. In 1959 394 communities obtained a net profit of $7.2-million through this device according to records of the State Public Examiner.

Considering the fact that nearly 30 per cent of state tax revenues for the General Revenue Fund comes from selective sales taxes on alcoholic beverages and tobacco products, one can say that state revenues depend significantly upon drinkers and smokers.

<u>HIGHWAY USER TAXES</u>

The belief that taxes ought to be propertioned to benefits received underlies Minnesota taxation of motor vehicles and motor vehicle fuels. Revenues from these taxes is constitutionally dedicated to highway building and upkeep.

Motor Vehicle Fuel Tax: Minnesota levies a selective sales tax on motor vehicle fuels. Because the tax is intended to be a highway-user tax, statutes provide exemptions and refunds on fuel used for other purposes. The largest exemption is for farm tractor fuel shipped and sold in the state, but refunds also are allowed for fuel used by engines other than motor vehicles or airplanes. Also those who regularly buy gasoline taxed in Minnesota but use it in other states can apply for refunds if the other states also subject them to highway use charges. In fiscal 1959 motor vehicle tax revenues of more than $54-million were reported. The Governor's proposed 1959-61 biennial budget estimated revenues of more than $57-million. At the same time, Minnesota's per capita 1959 revenue from motor vehicle fuel taxes was $15.92 compared to the 48-state average of $17.42.

<u>Motor Vehicle Registration Taxes</u>: The other major highway use tax is the motor vehicle registration or "license" tax. This tax in fiscal 1959 produced $38.8-million or $11.43 per capita. It is in lieu of personal property taxes on automobiles but at a sharply higher rate. Statutes in 1960 provided for seven different classes of motor vehicles, each subject to somewhat different tax treatment. Ordinary passenger cars were taxed on the basis of the manufacturer's shipping weight at rates which decreased as the auto grew older. Farm trucks were less sharply taxed, but urban trucks (those used to transport property exclusively within municipalities) were taxed about a third more

severely than farm trucks. In fiscal 1959, the combined revenue from the motor vehicle registration and fuel taxes netted Minnesota state government $92,953,000 or $27.35 per capita, the largest quantity of tax revenue from a single category of taxpayers. Aid from the federal government for highway purposes totalled $58,161,000.

Policy and Administration: Highway user taxes offer the legislator a ready and reliable source of revenue. They are not overly susceptible to narrow fluctuations of the business cycle. They cost relatively little to collect, and there is little taxpayer resistance to their increase. They are, to be sure, regressive in relation to income, but they can be kept reasonably proportionate to benefits received from public highways and roads. The most common criticism of the structures of Minnesota and a number of other states has been that they fail to apportion an adequate share of highway costs to some classes of users. Thus, the most frequent proposals for major policy changes come in the shape of claims that taxes ought to be increased on these classes.

Highway experts disagree about the precise proportions added to highway costs by heavy trucks and buses, because such computations require judgments by engineers on the cost factors. Thus, the Minnesota State Highway Study Commission (appointed by the 1953 legislature) turned to consultants, the Public Administration Service and the Automotive Safety Foundation, for expert advice. The Governor's Tax Study Committee staff relied upon reports of these consultants as well as some computations of its own. The efforts of these groups was directed toward seeking to calculate the fair share to be born by various users of highways and roads.

The calculations of these groups indicated that higher volume and weight of vehicles make stronger and better highways necessary in a variety of ways. They concluded that heavier commercial carriers created more highway costs than they paid for through taxes. Trucking groups regarded this as an attempt to shift a greater part of the highway cost burden to themselves. One of their trade organizations computed that heavy commercial vehicles created less than a fourth of highway costs but actually paid a full 25 per cent of use taxes. The legislature was then faced with conflicting expert opinion about what shares of highway costs ought to be borne by passenger cars and their owners; farm and urban truck owners, and commercial vehicles, particularly big over-the-road truckers and passenger buses.

The Governor's Tax Committee staff reviewed the controversy and accepted, for the sake of argument, the truckers' estimates of their tax load -- about 25 per cent. But in computing costs, they said that about 30 per cent of the highway cost burden came from commercial carriers, so the Committee eventually recommended sizeable tax increases for these carriers. It distinguished the heavy commercial truckers from lightweight and local farm trucks and also said that the legislature ought to consider some form of weight-distance tax on the commercial carriers.

<u>Weight-Distance Taxes:</u> Legislatures of a number of states have imposed some kind of weight-distance tax on commercial trucks. This tax is directed largely at interstate truckers, who may escape most property taxation. Put simply, it seeks to tax over-the-road trucking on some combination of weight and distance travelled on highways in the state. Advocates argue that these are a workable index for calculating the actual use made of the public roads.

In some states these advocates have been joined by railroad interests who feel that the trucking industry is unfairly subsidized by its ability to operate over public highways while railroads have to pay maintenance and costs of trackage. The Tax Study Committee noted that commercial truckers operating in Minnesota at existing tax levels did seem to enjoy this kind of advantage.

WHAT'S WRONG WITH MINNESOTA TAXATION?

The later months of the state election campaign in Minnesota brought taxation to the point of a central issue. The Republicans hammered at the "fiscal irresponsibility" of the incumbent Democratic administration. The Democrats challenged the Republicans to come forward with a tax program. Governor Freeman said that his position was clear; he was for "withholding" of the income tax. Elmer L. Anderson argued that the Freeman administration was seeking to obscure the way in which Minnesota's tax structure held back industrial growth and discriminated against various groups of taxpayers. Freeman accused Anderson of wanting to adopt a general sales tax so that burdens would be shifted from the well-to-do to the poor. He blamed immediate financial problems of the state upon the Conservative faction of the state senate in the 1957 and 1959 legislatures. He said that these senators had refused to support the reforms of the Governor's 1956 Tax Study Committee, particularly adoption of withholding of the individual income tax. The Republicans retorted that in 1957, Freeman's supporters in the House refused to fight for measures embodying some of the Committee's recommendations which had been passed by the senate.

As sometimes happens, a variety of real issues and accomplishments seem to have become obscured by the controversy.

1. Are Taxes Too High or Too Low? Common sense and a moderate knowledge of Minnesota state tax structures suggest that some taxes are too high on some taxpayers and others are too low for others. This is not equivocation but appreciation of complexities. Both the state administration and its opponents have agreed that the personal property tax bears unduly and in discriminatory ways upon industry and unequally upon other categories of taxpayers. Governor Freeman, however, noted that "programs designed ... to meet the challenge of the years just ahead" kept him from recommending a reduction to the 1959 legislature. A businessman retorted some time later, "Minnesota people are going to have to lower their sights a little on things they think they need." The businessman argued that continued taxation of business along current lines would tend to transform industries producing for national markets to industries supplying a smaller regional market. Listening to both, a political scientist wonders if both sides in the political controversy are not obscuring the more basic problem: If our goal is economic growth, what arrangements of taxation and public spending will contribute most to a high, sustained rate over a 10 or 20-year period? For example, if a well-educated pool of labor is sought, how much ought the state to spend each year in the next twenty to provide the numbers and kinds of workers who will be needed? By posing and answering such questions, we might swiftly discover that taxes are, on the whole, much too low to produce conditions which are necessary to the desired rate of economic growth.

2. Regressiveness in the State Tax Structure: Those who most desire lower personal property taxes have proposed a general sales tax to replace it. Governor Freeman rejected the device both in his 1959 budget message and 1960

campaign because he argued that it "bears most heavily on the people who can least afford to pay." Sales tax advocates point to the portion of the report of the Governor's Tax Study Committee which showed how to arrange a non-regressive general sales tax. Political arguments ignored the fact that most taxes currently relied upon to finance state activities already are highly regressive. An issue: Assuming that the tax structure ought not to be regressive, how should present regressiveness be reduced? A second: if a general sales tax can be made regressive, what objections can be raised to extending progressive taxation by this device?

3. What Is To Be Done About Dedicated Funds? Remarkably absent from partisan debate has been the effect of constitutional and legislative dedication of tax revenues. Two effects can be mentioned here. First, those functions and services which are supported in this way may flourish, while equally desirable functions financed from the General Revenue Fund may be starved and inhibited. Second, the legislature may be forced to depend unduly upon taxes like those on tobacco products or alcoholic beverages because raising other taxes will not put revenue into the funds where it is needed. But removing all dedication is an inappropriate device, because programs of large-scale highway construction, for example, require a steady and predictable revenue level over a five-to-ten-year period. In a variety of such areas, one legislature might mistakenly require short-run economies which will actually provide longer-term waste. Inadequate appropriations for maintenance of a variety of public buildings over a decade, for example, have been known to let buildings run down to such a degree that expensive "crash program" rehabilitation became the only solution. Thus an issue becomes: How can the legislature be brought to develop and pass measures to remedy a currently unfortunate dedicated-fund structure?

A great variety of other issues in Minnesota taxation can be mentioned. This discussion of taxation in the state has been long, but it actually is brief and superficial. For those wishing to know more, a short list of selections from periodicals and other reading material is appended.

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APPENDIX I.

TAX POWERS OF STATE AND LOCAL GOVERNMENTS*

The state's authority to tax is an essential part of its reserved powers, legally limited only by the restrictions found in the national and state constitutions. Local units partake of the tax power by virtue of authority delegated them by the state and must seek for the taxes they impose, therefore, specific justification in the state constitutional provisions or statutes that grant the authority to them. Local tax units, of course, are also bound by the restrictions in the national and state constitutions.

National limitations. Several national limitations on state tax powers are of consequence. From a long line of judicial decisions beginning with McCulloch v. Maryland in 1809, the states may not tax the property or activities of the national government, a matter of particular importance to governments in those states in which the nation owns much land and to those cities, counties, and towns in which valuable national buildings are located. The national government may waive its immunity, and it has done so in one important respect by making state income taxes applicable to federal employees resident in a state.

The states are also restricted by the national Constitution in their taxation of commerce. They may lay no tonnage, import, or export duties; nor may they tax in a way that interferes with interstate commerce, though they may tax property used in that commerce as long as they do not discriminate against it. The obligation to observe 'interstate citizenship' requires that out-of-state residents not be taxed more highly on property they own or business they engage in within a state than are the state's own citizens.

The 14th Amendment's 'due process' clause has several implications for state tax power. For one thing, it forbids a state to tax property not within its jurisdiction, though the question of jurisdiction for tax purposes has raised complexities. The due process clause has also been held to require that money be used only for a 'public purpose,' not for the exclusive benefit of any private person or group. Most courts tend today to accept the judgment of the legislature, however, as to what constitutes a 'public purpose,' and expenditures of particular value to the people of one area, occupation, income level, or interest are commonly allowed.

Of primary importance is the effect of the 14th Amendment's 'equal protection clause' on the state's tax power. 'Equal protection' does not prevent all classification for tax purposes; for to do so would make impossible taxation of all income earners, property owners, or cigarette users -- a ridiculous prospect. But it does forbid unreasonable and discriminatory classification, 'unrelated to the purpose of taxation,' and thus it prohibits taxes imposed on some such basis as race, religion, or political party membership. States may tax 'chain stores' at a higher rate than that imposed on stores operated singly, or corporations more than business partnerships; but they may not discriminate among chains or corporations of the same type on some unreasonable grounds.

State Imposed Limitations. State Constitutions usually impose restrictions on state taxation, either similar to or in addition to those to be interpreted from the due process and equal protection clauses. Local governments are commonly restricted closely by state constitutions and statutes, the kinds of taxes they may use often being prescribed and the amounts they may raise from them limited.

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* - John M. Swarthout and Ernest Bartley, Principles and Problems of State and Local Government, (New York: Oxford University Press), 1958, pg. 259-60.

APPENDIX II.

Consumption Taxes*

The following taxes may be regarded as taxes upon consumption:

1. Special excise tax: on individual goods and services
2. Selective sales tax: (Example, British purchase tax) -- like the special excise tax but on a broader category.
3. Gross income tax: (example: Indiana) -- covers all exchanges with no distinction as to levels (retail or wholesale) or as to commodities and services.
4. Turnover tax: (used in Germany) much like (3) though less inclusive of services.
5. Transactions tax: extends beyond exchanges as (3) to cover such transactions as bank deposits.
6. Manufacturers' sales tax: (used in Canada) confined to sales of commodities at the manufacturer's level.
7. Retail sales tax: (Michigan) confined to sales at retail; may include some services and final sale of some capital goods like the sale of a cash register to a merchant.
8. Value-added tax: resembles a gross income tax in which an effort is made to avoid duplication by allowing deduction of cost of goods sold.
9. Overall spending tax: resembles a net income tax except that the levey is made on total annual spending (allowing exemption of savings and investments).
10. Use tax: a supplementary levy on the use or possession of a commodity which is not taxed upon its acquisition.
11. Net income tax without personal exemptions: (Philadelphia) frequently is called a gross income tax although it really is on net income.
12. Tariff or customs: tax on goods bought or sold in foreign trade (constitutionally prohibited to the states in the U.S.).

* - adapted from Harold M. Groves, Financing Government, (New York: Holt, 1955, pg. 253.