THE PLACE OF THE INCOME TAX
IN STATE TAXATION
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INTRODUCTION. In a review of the developments of tax legislation during 1919-20 given before the National Tax Association in 1920, Mr. O. C. Lockhart made the following statement. "The outstanding feature of this legislation has been the effort to raise increased revenue. Whether we like it or not, or whether we think it a desirable tendency or not, it is undeniable that our state and local expenditures have increased much more rapidly than revenue." This same tendency for public expenditure to increase has been pointed out by nearly every recent writer in public finance and has been a matter of increasing concern to politicians and legislators, who are charged with the duty of finding new sources of revenue to meet the increasing expenditure. Among the new forms of taxation proposed for the solution of this problem is that of the income tax. Mr. Lockhart in continuing his speech said that the most notable of the new developments, was that of state income tax.

An income tax is a tax levied on income of a person, firm or corporation. Income may be defined as the annual receipts of a person or corporation. Prof. Adams says the purpose of the income tax is to tax the sum which comes to an individual or corporation during a definite period of industrial activity. However in the case of income tax a distinction is usually made between gross income and net income. By gross income is meant income from gains, profits, wages, compensation for personal services, interest, rent, dividends or

returns of any kind from any source whatever. By net income is meant gross income less certain deductions provided for in the laws of the commonwealth. It is usually the net income which is made the object of taxation.

The rates by which the income is taxed may be either proportional, degressive or progressive. By proportional rate is meant one by which the same proportional or fractional part of the income is taken, regardless of whether the income is large or small. A degressive rate is one which takes a proportionally smaller part of the total, as the income increases in size. A progressive rate on the other hand takes a proportionally larger part of the total as the income increases in size. To enter into a full discussion of these different rates would lead us too far off the subject under consideration. It will suffice for our purpose to simply make a few generalizations. It is the generally accepted view of those, who have given the subject careful consideration that progressive taxation of incomes most nearly achieves equality of sacrifice, if the idea of ability to pay is taken as the basis of taxation. This idea has been followed by nearly every state which has recently enacted income tax legislation. In the discussion which is to follow therefore it may generally be inferred that this is the form of taxation under consideration. In regard to what these rates should be we will probably have more to say later. However where the considerations advanced will be affected differently by the various rates we will endeavor to point out such schemes of any [illegible] whatever. [illegible] [illegible] [illegible] [illegible] for in the [illegible] of [illegible]. It is [illegible] which is [illegible] of taxation.

[illegible] proportional, progressive or regressive. By a proportional rate is meant one by which the same proportion or percentage part of the income is taken irrespective of whether the income is large or small. A progressive rate is one which takes a proportionally larger part of the small, as the income increases in size. A regressive rate on the other hand takes a proportionally larger part of the small [illegible] the income increases in size. [illegible] [illegible] [illegible] [illegible] [illegible] different rates would [illegible] [illegible] [illegible] [illegible] consideration. [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible]. [illegible] [illegible] generally accepted view at [illegible] [illegible] the subject careful consideration that progressive taxation at [illegible] [illegible] [illegible] equality of [illegible]. [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] nearly every state which has [illegible] [illegible] income tax legislation. [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] it may generally be [illegible] [illegible] [illegible] [illegible] form of [illegible] [illegible] [illegible]. [illegible] [illegible] [illegible] [illegible] should be [illegible] [illegible] [illegible] [illegible] [illegible]. [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] differences as we go along.

The use of an income tax represents nothing new in the history of taxation, but rather an endeavor to readjust an old form to a modern use. According to M. H. Hunter (Public Finance p. 304) a form of income tax existed in several of the American colonies previous to the Revolutionary War, and there has never been a time in the history of the United States in which an income tax has not been in operation in one or more states in some form.

Thus, the income tax has been on trial more or less unsuccessfully throughout the history of the nation. Only recently has it assumed much importance as a source of taxation.

In recent years an increasing number of states have turned to it as a source from which to draw revenue for their increasing expenditures. Virginia has had an income tax since 1874, but the rate was low, a proportional rate of 1%, and the amount of revenue collected has been neglible. Moreover the administration of the law has been poor and the cost of collection rather high. A considerable number of states, including Pennsylvania, Maryland, Alabama, Florida, Missouri, Texas, Georgia, West Virginia, Louisiana, Kentucky, Deleware, and Tennessee have tried the income tax for a period of time and then abandoned it. Other states such as Massachusetts, and North Carolina have retained it but have revised their laws from time to time in the effort [illegible] by the state.

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[illegible], the lottery has [illegible] throughout the history of the nation, [illegible] as a source of taxation.

In [illegible] the lottery [illegible] have turned to it as a [illegible] for their increasing expenditures. [illegible] since [illegible], but the [illegible] of it, and the [illegible] has been [illegible]. [illegible] of the [illegible] and the [illegible] rather high. A considerable number of states, including Pennsylvania, Maryland, Alabama, Florida, Mississippi, [illegible], Georgia, West Virginia, Kentucky, Delaware, and Tennessee have tried the lottery for a [illegible] of time and then abandoned it. Other states such as Massachusetts, and North Carolina have [illegible] it but have [illegible] their [illegible] from time to time in the effort to secure more successful operation. In summing up therefore, it may be said that nearly all of these early efforts have resulted in failure.

RECENT DEVELOPMENTS IN INCOME TAX. During the past twelve or fifteen years an increasing number of states have been turning to income tax as a source from which to meet their increasing budgets. In 1911 Wisconsin passed an Act imposing a tax on all incomes produced within the state. The rates provided for are progressive and a separate set of rates are provided for individual incomes and for corporate incomes. Oklahoma passed an income tax law in 1908 but it was very unsatisfactory and consequently was revised in 1915. By this act a tax was imposed on the net income of each and every person in the state and on the entire net income from all property owned and from every business carried on within the state.

Connecticut passed a law in 1915 also which requires each corporation to file with the tax commissioner a copy of the return sent to the Federal Internal Revenue Department. A tax of 2% is imposed on the income of such corporation. West Virginia also passed an income tax law in 1915. This law requires the state tax commissioner to determine the net income and assess the tax at a rate provided in the law. The Massachusetts income tax law which was passed in 1916 applies only to certain forms of income such as those derived from the various forms of tangibles

and incomes derived from annuities, trades and professions. The rates in this state vary with the type of income. The state of New York passed a law in 1917 levying a tax of 3% on the incomes of corporations. In 1919 an income tax law with progressive rates on personal incomes was passed and the rate on corporate incomes advanced to 4½%. The income tax law of Missouri is modeled on the Federal Income Tax Act. It was passed in 1917 and imposes a flat rate of 1½% on all incomes. The state of Montana also passed an income tax in 1917 imposing a tax of 1% on the incomes of corporations within the state. The fourth state passing an income tax law in 1917 was Delaware. This Act provides for the tax of 1% on personal incomes in the state, but does not apply to the incomes of corporations. During 1919 New Mexico adopted an income tax applicable to all persons, firms, corporations, etc. having a place of business within the state. The rates were progressive being graduated from ½% to 3%. North Dakota also adopted an income tax 1919. This law distinguishes between earned and unearned income with a different set of rates for each. The income tax law enacted in Alabama during 1919 was declared unconstitutional on the basis that the rate exceeded the constitutional limit.

During 1920 a constitutional amendment was passed in North Carolina permitting the use of an income tax, the rate of which, was not to exceed 6%. The law was enacted

in the following year. The rates are 3% for corporate income and a graduated rate of from 1% to 3% on personal incomes. South Carolina which had repealed an income tax law in 1918, enacted a new law in 1922 based on the Federal Income tax law, whose principles it follows in regard to levy, assessment, and collection of the income tax. This shows the recent developments in regard to income tax in state taxation and is proof of the fact that the income tax is assuming an increasing importance as a form of state taxation.

Quite a few of these laws have been revised somewhat since their passage; therefore, I shall endeavor to give a brief summary showing the status of the income tax at the close of 1923.

1. Arkansas has a personal income tax of one-tenth of one percent. This tax is peculiar and unlike any other income tax in that the tax is levied on gross income, whereas all other state income taxes are levied on net income.

2. The income tax in Delaware applies to personal income only. The rates are progressive varying from one to three percent.

3. Massachusetts levied an income tax on both personal and corporate incomes with a different set of rates for each. The rate on personal incomes varies from one and one-half to six percent. The rate on corporate incomes is two and one-half percent.

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3. [illegible]
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[illegible]
[illegible]

4. Mississippi levies a tax on both corporate and personal incomes at the rate of one half of one percent.

5. Missouri has a proportional rate of one percent on both corporate and personal incomes.

6. North Carolina has graduated rates varying from one to three percent. They are applied to personal incomes only. Corporate incomes are also taxed at the rate of 3 percent.

7. New York state has progressive rates graduated from one to three percent on personal incomes and proportional rates of four and one half percent on corporate incomes.

8. North Dakota has a progressive income tax with rates graduated from one to six percent on personal incomes. There is also a proportional rate of three-fifths of one percent on corporate incomes.

9. Oklahoma taxes personal incomes only at rates graduated from three-fourths of one percent to two percent.

10. Oregon taxes both personal and corporate incomes at progressive rates of from one to six percent.

11. The income tax in South Carolina for personal incomes is based on the Federal income tax. The rates are one third of the Federal rates thus varying from one and one-third percent to eighteen percent. A flat rate of four and one-sixth percent is imposed on the income of corporations.

12. Virginia imposes an income tax on both personal

and corporate incomes. The rate on personal incomes is one percent for incomes from one thousand dollars to three thousand dollars and two percent on incomes over three thousand dollars. A proportional rate of one-half of one percent is levied on corporate incomes.

13. Wisconsin levies an income tax on both corporate and personal incomes with progressive rates for each graduated from two to six percent.

14. The income tax in Connecticut is levied on corporate incomes only, at a proportional rate of two percent.

15. Montana assesses an income tax also on corporations only. The rate is a proportional one, of one percent on all such incomes.

16. Tennessee also has an income tax with a proportional rate of three percent applying only to corporate incomes.

17. New Mexico has an income tax applying to both individual and corporate incomes. The rates being graduated from one-half of one percent to three percent.

18. West Virginia has an income tax but information in regard to its details has not been secured.

This makes in all eighteen states having some form of income tax. An examination into these laws will at once reveal the fact that there exists a great lack of uniformity in the following points, kinds of rates, amount of rates, exemptions allowed, kinds of incomes liable to taxa-

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11. [illegible] income [illegible]
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12. The income tax is [illegible]
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13. [illegible]
tive only. [illegible]
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14. [illegible]
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income.

15. [illegible]
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tion and methods of administration in different states. According to the information at hand ten states employ graduated progressive rate on personal incomes while four make use of a flat or proportional rate. Out of the thirteen states taxing corporate incomes only three use progressive rates. The proportional rates on personal incomes vary from one-tenth of one percent to two percent, while on corporate incomes the variations runs from one-half of one percent to four and one-half per cent. There is more uniformity in regard to the progressive rates used in the case of both corporate and personal income the lower limit of such rates varying from one to two percent and the upper limit being in nearly every case six percent. The only notable exemption to this fact is found in South Carolina where the upper limit reaches eighteen percent.

Some states provide separate rates for individual and corporate income, others do not. North Dakota distinguishes between earned and unearned income and provides a different set of rates for each.

In regard to the kind of income liable to taxation we find the same lack of uniformity. Many states impose a tax on both personal income and corporate income. Other states like Connecticut and Montana tax corporate incomes only. On the other hand Delaware and Arkansas tax personal incomes only.

The amount of exemption allowed also varies in the

different states. The majority of states follow the plan of the Federal Act in this particular case. The Federal Act allows exemptions of $1000 for single and $2000 for married persons, also an additional deduction of $300 for each dependent. Many states have adopted these amounts but there are several exceptions. Wisconsin has reduced them to $800 for unmarried and $1200 for married persons. Montana and Mississippi each allow an exemption of $2500. Oklahoma has been even more liberal in this respect allowing an exemption of $3000 with an additional deduction of $1000 for wife or husband and from $300 to $500 for each dependent.

The administration also varies from state to state depending somewhat on the administrative machinery already in existence. Where the state has a tax commission, the administration is usually placed in the hands of this body. This is done in the state of New York. In Massachusetts and West Virginia the administration is in the hands of the state tax commissioner. Of the details of the system worked out by the various states we shall have more to say further on.

The above summary shows fairly well the development and present status of the income tax in the commonwealth of the United States. The points enumerated above show the utter lack of uniformity existing among the different states. This lack of uniformity gives rise to problems of a rather important nature on which we shall have

more to say later. This summary shows the increasing prominence given to this form of taxation as the great majority of states having income tax have adopted it within the last decade. The income tax has been in operation in a number of states long enough for us to get some opinions of its workings. The fact that so many states have adopted it is of considerable significance. But the most important thing is to know how it works in practice. We can perhaps get a better idea of its usefulness by its actual workings than by any other method. The criterion of a good tax should be its ability to secure an adequate amount of revenue, by fair and equitable means and get it with the least outlay possible. In this connection it may be said that the recent laws have been in operation for too short a time to furnish much information on this point. But several states have had income tax long enough to throw some light on this question.

Prof. Comstock published an article in The American Economic Review, April 1920, in which a study was made of the working of the income tax in various states in comparison with the working of the Federal income tax in the same states. It was pointed out in the article that industrial states were richest in regard to income and at that time Massachusetts was the only great industrial state having an income tax that had been in operation long enough to judge anything from its workings.

In that state the rates were low, but in 1918

revenue amounting to $14,000,000 was collected from income tax. In Wisconsin during the period 1912-1918 the returns from income tax increased 172%, while the return from property tax during the same period increased only 47%. The cost of collecting the tax was also low amounting to only about 1% of the total. Yet in 1918 the amount of tax collected from incomes in the state of Wisconsin amounted to only about one-tenth of the entire revenue of the state.

The state of Oklahoma in 1916 collected $400,000 by income tax but this amount formed only 1½% of the total state revenue. This shows that the income tax in the tax system of this state is not of great importance. The Federal government in the same year collected $5,500,000 in Oklahoma by income tax. The small revenue collected in this state in proportion to the amount collected by the Federal Government is due, at least in part, to the high exemptions allowed in Oklahoma.

Missouri with very low rates collected $616,000 in 1918 which was 4% of the total state receipts. The rates were increased in 1919 and a larger return was expected. The state of Delaware in 1918 collected $400,000 from income taxes which was one-fourth of the general fund of the state. But since this state levies no property tax it cannot be compared with other states. The amount of revenue collected by income tax in Virginia in 1917 was $660,000 but during the same time the Federal government

collected $23,000,000 from the state in income tax. Moreover the cost of collection on the part of the state was very high, being about 4% of the total revenue derived from this source. It is however unfair to compare the revenue derived by state income tax with that derived by the Federal tax because the Federal tax is more steeply graduated than are the income tax laws of the various states.

Recent reports would seem to show that, at least in some states, the income tax is increasing in importance as a source of state revenue. The receipts from income tax in Massachusetts in 1921 were approximately $46,000,000 or one-fourth of the total tax collected in that state. This is over three times the amount collected in that state in 1918. Wisconsin collected $16,000,000 from income tax in 1921 which was one-seventh of the total revenue of the state, whereas in 1918 the tax on incomes amounted to only one-tenth of the total. In 1920 New York state collected $78,000,000 from income taxation which was one-fifth of the entire revenue of the state in that year. It should be remembered however in this connection that incomes in 1920 and 1921 were somewhat larger than has been generally the case since that time. This is shown in the case of Virginia who collected approximately $5,000,000 of income tax in 1920 which was one-fifth of the entire revenue. The amount has been declining since that time, so that in 1923 it was only $1,100,000 or less than five percent of the total revenue.

collected $49,000,000 from the state income tax. More-
over the cost of collection on the part of the state was
very high, being about 9% of the total revenue derived from
this source. It is however unfair to compare the revenue
derived by these states with the federal revenue of the same
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In some states the income tax is [illegible] generally [illegible]
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state, whereas in [illegible] amounted to only
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total revenue.

The amounts collected by the taxation of incomes in other states has been rather negligible. Professor Comstock says the cost of collection varies from 4% in Virginia to 1% in Wisconsin. From the figures given above and from the general opinions expressed in the Bulletins and Proceedings of the National Tax Association the income tax forms an important source only in the states of Wisconsin, New York, and Massachusetts. In other states the amount of revenue collected by this method is not very large in proportion to the total revenues collected.

Concerning the reasons for the apparent lack of success of the income tax in so many states and its apparent success in others we shall have something to say when we discuss the problems of the income tax. The conditions set forth above serve to bring out the fact that the usefulness of income tax as a part of the state tax system is still a matter of doubt so far as its practical working is concerned. This leads us to the question, what is the place of income tax in the state tax system? Does it offer a practical source of state revenue? And if it does, how important a place should it be given? What are its possibilities and what are its limitations, what peculiar problems does it give rise to and what solution may be proposed for those problems? To the consideration of these questions we will now turn our attention.

We will begin first by a study of the justification of income tax. This will in turn be followed by a dis-

The outward movement by the location of [illegible] in other [illegible]. [illegible] [illegible] [illegible] [illegible] the [illegible] [illegible] amount of [illegible] large in [illegible].

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We will begin first by a study of the [illegible] tion of [illegible]. This will be [illegible] cussion of the objections to income tax and the actual problems that arise from it, and at the same time endeavor to point out some of the solutions that may be used for these problems. The relation of income tax to other forms of taxation forms another important topic for consideration, since many of the problems of income tax arise from this source. Finally with the above discussion as a basis we will try to draw some conclusions in answer to the question raised above.

ARGUMENT FOR INCOME TAX. The justification of income tax must to a considerable extent be of a theoretic nature, yet this should not detract from its value unless it can be shown that in actual practice the considerations advanced will not hold good.

To begin with we shall lay down the principle that all taxes are paid out of income unless the amount of the tax is greater than the income of the individual. Such a principle seems to us to hold good both from the theoretical viewpoint and in practice. Prof. Taussig says, in his Principles of Economics p. 519, that ultimately all taxes are derived from income, and though many taxes in the first instance, are levied, not with respect to income, but with respect to houses, lands, or commodities, these taxes fall eventually on some one's income, even if not on that of the first person charged with their payment. Let us examine for a moment some of the common forms of taxation and see if our principle is true in each case.

Taxes on land and real estate are the most common form of state taxation. Are such taxes paid out of the income from the land? In no case does the owner take a part of the land to pay the tax unless the amount of the tax exceeds the income from the land. The owner does not sell a part of the land to pay his tax but pays it out of the income of the land. The same would be true in regard to tax on any personal property whether tangible or intangible.

Another form of tax very commonly used is that of the commodity tax. This tax is levied with respect to commodities consumed. But such a tax is in no case paid by commodities. This fact is true whether the tax be direct or indirect, whether it falls on the producer or is ultimately shifted to the consumer. If the producer is forced to pay the tax it is paid out of the income from the business. If on the other hand the tax be shifted to the consumer it is again paid out of the income of the individual who consumes the commodity because the tax is added to the price of the commodity and the consumer pays for the commodity out of his income except where expenditure is made out of savings.

The franchise tax is another very common form of state taxation. An examination of such tax will reveal the same fact as shown in the forms previously mentioned, namely that it is paid out of the income of business which is carried on by the person, or firm, holding the franchise. The same is

Taxes on land and real estate are the most common form of state taxation. Are such taxes paid out of the income from the land? In no case does the owner have a part of the land to pay the tax unless the [illegible] that exceeds the income from the land. The owner does not sell a part of the land to pay the tax but pays it out of the income of the land. The [illegible] [illegible] [illegible] to be [illegible] out of the [illegible] [illegible] [illegible] [illegible] or the complete.

Another form of tax very commonly used is that of the commodity tax. This tax is levied with respect to commodities produced. For such a tax is borne most well by consumption. This form of tax [illegible] the tax as direct or indirect, because it falls on the producer as it ultimately shifted to the consumer. If the producer is forced to pay the tax it is paid out of the income from the business. If on the other hand the tax be shifted to the consumer it is again paid out of the income of the individual the consumer. In commodity taxation the tax is added to the price of the commodity and the consumer paid for the commodity out of his income without which commodities he would not at all.

The income tax is another very common form of state taxation. An examination of such tax will reveal the same fact as shown in the forms previously mentioned, namely that it is paid out of the income of business which is derived by the owner, in turn, helping the taxation. The same is true of license taxes which are another important form of state taxation. Thus it is easily seen that in no case does the owner dispense with the thing on which the tax is levied in order to pay the tax, but in every case it is paid out of the income derived therefrom.

The only exception to this principle is the case in which the tax exceeds the income derived. This may take place in a bad year in which the business carried on, does return an income sufficient to pay the tax levied, or in the case of land the season may not be a prosperous one and land will fail to produce enough to pay the tax. Again the farmer may not be able to market his product and so will not secure an income large enough to pay the tax. Under such conditions the tax evidently cannot come out of the income at that time but the tax will be paid most probably out of the past income and the taxpayer will expect to make up the loss in the future. Even here the tax ultimately comes out of income though in some cases the income is not derived immediately previously to the payment of tax. But such conditions as these are only temporary phenomena and do not affect the ultimate results of taxation. A condition might be possible however where the amount of tax might permanently exceed the income derived from the object of taxation. Such conditions have actually existed as was the case with taxation of state bank notes in order to reduce their circulation. Such taxation has also been urged for various purposes of reform.

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But such taxation constitutes an exception to general conditions and is not urged for the purpose of securing revenue.

In general we may say that the amount of tax levied on any individual or business is paid out of income, with the exception of such taxes as are used for purposes of reform or to prohibit the existence of certain conditions or the use of certain things. But for purposes of revenue, we may say that any tax which exceeds is necessarily unjust and uneconomical. In the first place, it must be partly paid out of savings or capital, which in turn reduces the efficiency of the individual, or his ability to produce wealth in the future. This will in return reduce the source from which the future revenues of the state must be derived. Such taxation should always be avoided. Continued production requires replacement of capital and this in turn requires that some one must save in order that the funds may be secured with which to purchase capital. Where taxation exceeds income, it not only destroys the fund from which such capital is purchased, but a part of the capital already existing is used up to pay the tax. Such taxation can only lead to bankruptcy.

Moreover where taxation exceeds income, it must of necessity reduce the standard of living and deprive the individual of the comforts of life. In the light of such considerations, it is safe to lay down the principle that tax should in no case exceed income if the future source

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In respect of [illegible] the [illegible] of the individual as [illegible] individual or [illegible] of [illegible]. With the [illegible] of such [illegible] as [illegible] the purposes of [illegible] or to [illegible] of certain conditions to the [illegible] of [illegible]. [illegible]

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[illegible] Moreover [illegible] of [illegible] the [illegible] of [illegible] and [illegible] individual [illegible] of [illegible] life. In the [illegible] of [illegible], it is safe to say that the [illegible] of revenue is to be preserved, and the welfare of the taxpayer safeguarded. Since the income tax is definitely based on income, it would avoid any such dangers.

It is generally accepted that the amount of the tax imposed on the individual should depend on the ability of the individual to pay the tax. This idea seems to be in harmony with the concept of justice and equity in taxation. However when we come to define what constitutes ability to pay the problem may be somewhat complicated. But in general the ability to pay depends on what the individual has to pay with. Under ordinary conditions the expenditures of an individual are always made out of income. The ability of the individual to spend is determined in the lung run by his income. With few exceptions we may say that expenditures rarely come out of property owned or out of savings. Any exceptions to this fact must of necessity be very uneconomical since they not only reduce savings and the capacity to produce more wealth, but also tend to wastfulness and uselessness in the expenditure.

Tax forms one of the items of expense in the budget of the individual and, since his ability to spend is measured by his income, it seems that his ability to pay tax is measured also by income. It is evident that his ability to spend for other things will be reduced by the amount of the tax. And unless the amount of the tax levied is measured with respect to income the proportion taken may be too large so that it will not leave the individual of persons is to be preferred, and [illegible] higher intelligence. Where the [illegible] based on income, it would [illegible].

It is generally [illegible] that the amount of the tax imposed on the individual should depend on the ability of the individual to pay the tax. This does [illegible] to be accepted [illegible] tion. However [illegible] ability to pay the [illegible] classification. [illegible] the ability [illegible] individual has to [illegible]. Some [illegible] of an individual [illegible] of income. The ability of the individual to [illegible] his income. [illegible] taxes, [illegible] out of [illegible] or [illegible], or [illegible] any [illegible] to [illegible] [illegible] to produce more wealth. [illegible] and [illegible] in the [illegible].

[illegible] one of the [illegible] of [illegible] the individual. [illegible] ability to [illegible] the tax is measured [illegible]. [illegible] ability to [illegible] of the amount of the tax. [illegible] may be [illegible] individual the proper amount to meet his necessary expenditures with. Again it may take a larger part of one income than of another and thus work injustice as between different individuals, where the larger proportion is taken from the smaller income. If we examine a few of the common forms of state taxation we shall see how this can take place.

Take for example a tax on land. The land is assessed at a certain valuation and the rate of taxation is prescribed so that the tax will vary only as the assessment is changed from time to time. Changes in the assessment however take place very gradually and only small changes occur in any single year and as a result the tax remain fairly uniform from year to year. On the other hand the return from the land in a bad season or in a time of depression when markets are bad, may not be enough to pay the tax. The same considerations might be advanced in regard to other forms of taxation. The possession of so much property, while an evidence of income, is not a measure of income. But the ability to pay taxes is measured by the amount of income out of which the tax must be paid. Thus we attempt to draw tax from income without any regard to the measure of the income from which it is to be paid or of the ability of the taxpayer to pay. A tax levied on income direct would avoid all danger of exceeding the income from which it is to be paid and also of reducing the amount of capital in present use as well as the replacement of capital for future use in production. This in turn would insure the proper amount to meet his necessary expenditures with, again it may have a tendency to [illegible] the [illegible] of [illegible] and thus work [illegible] to [illegible] individuals, since the larger [illegible] in [illegible] the [illegible] does. [illegible] the [illegible] of [illegible] [illegible] to [illegible] and not [illegible] its true place.

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the source from which the future revenues are to be derived. Thus the future prosperity of the state would be better insured.

Not only does the income from the same property vary from time to time in such a way as to make property unfit for use as an index to the income of the individual or corporation, but also the income varies with the kind of property held. Some kinds of property produce a greater net income than other forms of property. It may be argued that the value of any kind of property depends on the capitalization of the income derived therefrom at the current rate of interest. This is true to a very large extent but at the same time it is not made the basis of assessment. The assessor knows nothing about the income when he assesses the property in question and as a result some forms of property are assessed at a much higher value in proportion to the income which they bring in than are other forms of property. The result is that some individuals are forced to pay a higher tax in proportion to their income than others. Such taxation is evidently unjust if justice is based on the ability to pay. Thus income is the fairest measure of the ability to pay.

Again income tax is a direct tax and is difficult to shift on to some one else, whereas many of the present forms of state taxation are indirect at least. They are partly shifted on to some one else and in this shifting

there is no reference what ever to ability of the individual on whom they finally fall, to pay the tax.

A progressive income tax has also been urged on the ground that it would tend to equalize the distribution and ownership of wealth. This argument would obviously not apply to an income tax with a proportional rate. The value of the argument moreover depends on whether such a change is desirable or not. It must be remembered that the capital necessary for the maintenance of production is derived from savings. Moreover the great mass of saving is done by those whose incomes are large. If such incomes are subjected to too heavy taxation it will be reflected in decreased production and the source from which revenue is drawn will be depleted to that extent.

Again income tax has also been urged as a substitute for the taxation of intangible property. The taxation of intangible property is very difficult to administer because of the ease with which it can be evaded. There is no means of finding out the amount of intangible property held except by the declaration of such property by the owner. This causes a strong tendency to conceal such property. Because of this fact many nations have given up the property tax on intangibles as being too difficult to administer and as costing too much to collect. Great Britain is a notable example in this line. The state of Massachusetts has substituted an income tax for the old tax on intangibles. One of the reasons for the Wisconsin income tax law was the

desire to find a substitute for the property tax which was so unsatisfactory. The fact that taxation of intangible property depends on the declaration of the owner still further increases the tendency to conceal property, when we consider that such a declaration works a hardship on the man who declares such property as against the man who does not. Moreover such property is usually not assessed with reference to income derived therefrom and this results in inequalities of taxation.

It is held that under an income tax, since every man must make a statement of income, he would be less apt to make a false return than where no statement was required. Then too inequalities of assessment would be avoided. There seems to be some truth in this contention. Mr. I. L. Shaw who has been connected with the administration of the Massachusetts income tax for six years made a statement before the National Tax Association in 1922 that, "from the best figures they could secure, under the income tax, it seemed that intangibles had contributed more than double the revenue which had been secured from them under the old property tax system in Massachusetts."

There is still another consideration in this connection. In most states where intangibles are listed they are subject to an unjust discrimination because of the fact that they can not be easily undervalued, but must be listed at their full market value. In most cases however they

bear the same rate as tangible personalty and real estate. These last named objects of taxation are woefully undervalued in nearly every case. Thus intangibles pay a much higher tax in proportion to their value than other forms of property. The knowledge of this fact increases the tendency to evasion on the part of the taxpayer. An example of this fact is found in the condition in Virginia recently. The average assessment of real estate in Virginia was computed to be approximately 41% of the fair market value for the entire state. Assuming that intangibles were assessed at their full value under such conditions they would pay a tax two and one-half times as great as real estate in proportion to their true value. Such inequalities exist in many cases under the old general property tax. One evil effect of such conditions is that there is danger of hindering the use of, or driving out capital, that would otherwise be used to develop the future productive resources of the state and thus curtail in the long run the sources from which the state must get its future revenue. The income tax has been recommended as a substitute for the tax on intangibles on the ground that it would do away with these inequalities, since it is based on income, whereas the tax on intangibles bears no relation to the income derived from such property. The income tax would also do away with the discriminations against intangible personal property.

Indeed the whole property tax is open to criticism on this score. Because of the great diversity in the forms

of property, each having a different rate of return and the fact that there is no method by which a just and equal evaluation of such property can be made, some students have been led to say that the entire system of the property tax should be done away with and an income tax substituted therefor. Professor Seligman after discussing the inequalities of the property tax says the next step in regard to the problem is the substitution of an income tax for the general property tax. From what has already been said on this question, it seems that such a conclusion is justifiable. However others are doubtful as to whether this forms the solution of the problem, and as to whether the income tax will ever replace the property tax, since the former presents many difficulties, just as does the property tax.

Another consideration in favor of the income tax is the fact that the returns may be very easily increased by simply increasing the rates. When the system is once in operation, it will cost no more to collect an increased amount of revenue, and this can be done by simply increasing the rates when an additional amount is needed. However there is a limit to which such increases must be confined and beyond which serious evasions will take place. Therefore they must be kept within reasonable limits. Along with the fact pointed out above it may be noted also that the revenue from income tax tends to increase with the increase in wealth and income of the tax paying community.

From the above point of view the income tax seems

very plausible, yet it is not a cure all in tax problems and presents some important difficulties to which we will now turn our attention.

PROBLEMS AND OBJECTIONS. In connection with the problems of income tax our attention will be largely devoted to those problems which have arisen with the income tax in actual operation.

The first problem which arises in connection with the assessment of income is the difficulty of determining income. Prof. H. C. Adams says the purpose of income tax is to tax the sum which comes to an individual or corporation during a definite period of industrial activity. Just what may be meant by the term sum is not certain but it would seem that it might be construed to mean gross receipts. As we have already noted only one state levies an income tax on gross receipts. Moreover we believe that such a tax is open to very serious objection on the ground that it will result in inequalities. Take for example a corporation or individual engaged in some form of business having high fixed charges, the income from such business may be very large but at the same time the expense of carrying on the business may nearly equal the gross receipts so that actual profit may be small. To tax gross receipts under such conditions would evidently work a hardship. A better definition we believe, is that given by Mr. Louis Wollbrinck who says that the purpose of income tax is to tax the income of the individual and allow the deduction of the expense incurred in creating

that income. This definition gives us a sufficient idea of the income tax to serve as a starting point in making an analysis of this problem.

Even though the taxation of gross receipts would work a hardship as we have tried to show yet the determination of the amount of income to be taxed, we think should at all times begin with a determination of gross income. It might even appear at first thought that gross income should be the basis of the tax but a few simple observations will reveal the weakness of such a position.

It is obvious to begin with that certain deductions must be made for the maintenance of at least, the minimum of subsistence on the part of the taxpayer and as we have shown above for the expense in creating the income. But even then these deductions must be made from gross income which must first be determined.

However we are confronted with difficult problems in some cases even in determining the gross income of an individual because certain forms of income do not appear as income. One of the most obvious cases of this kind, is found where a man owns the house in which he lives, as against the man who does not. The man who owns such property if he would rent it out would receive a definite income on the same, but since he uses it himself this income does not appear whereas his neighbor who rents the dwelling in which he lives, must secure a larger income in order to pay the rent, and if the idea of equality is adhered to he should be allowed

to deduct the amount so paid from his taxable income. But in most cases this is not allowable. A like condition obtains where the individual, as in the case of farmers has income in the form of a living. Such a form of income is most difficult to measure with any accuracy but it is nevertheless a very definite source of income. To allow the man who must procure his living out of his income the right to deduct the amount spent therefor, would again be dangerous since some individuals might live far beyond what was necessary for comfort or waste their income in luxury thereby escaping taxation. Such a policy would encourage waste and discourage saving because it would work a discrimination against the individual who saves as against the one who does not.

Since gross income is the starting point in the determination of the amount of income subject to taxation, it is obvious that some means must be devised to include those forms of income which do not ordinarily appear as income. However such determination will to some extent be arbitrary but there seems to be no reason why they can not, at least be approximated. Where the taxpayer lives in his own house there is no reason why the approximate rent which the house would bring, if let, cannot be arrived at from the general rates of rent which prevail. Again where the individual receives income in the form of a living from property some such method must also be followed but in this case the problem is some what more difficult. So far as we have been able to ascertain no state has yet successfully solved this problem. Wisconsin

for a time indeed tried to include house rent in returns under the conditions that we have described above, but soon gave it up because the results secured were not sufficient to justify the effort. Nevertheless the fact remains that unless some solution is found for these two problems in determining gross income, that a discrimination will exist in favor of the individual having such forms of income. Prof. Lutz in an article on income tax in the American Economic Review for March 1920 says the one point in which all income tax laws need improvement is in the matter of discrimination which operates against those who live in cities and in favor of those living on farms where the means of subsistence is produced. Deduction of living and family expense is not permitted in making the returns for income taxation, yet farmers are able to secure such. The same principle operates in favor of those who live in property which they own as against those who live in rented property.

Prof. Lutz thinks that this discrimination might be avoided by more careful administration, but does not give details.

When once the gross income has been determined the further problem arises as to what deduction and exemptions shall be allowed therefrom. There is a wide divergence on this point among the various states using income tax. Nearly all states exempt a certain amount of income for several reasons. First on the ground that a minimum is necessary for subsistence and therefore should not be taxed, because

to do so would deprive the receiptient of some of the necessaries of life and lower the standard of living. In the second place the revenue derived from such incomes would not be equal to the cost of collection. The amount exempted under this provision varies greatly, ranging from $800 to $3000 for single persons in various states. Exemptions are also allowed in nearly all states for dependents but these vary also to a considerable extent, ranging from $400 to $1000 for wife or husband and from $200 to $500 for each child or other dependent. There is a general feeling that exemptions of this kind should be placed at a lower figure rather than at a higher level however. The recommendations on this point embodied in the plan for a Model system of State Taxation as worked out by the committee of the National Tax Association are to allow exemptions of $600 for single and $1200 for married persons with an additional $200 for each dependent. While it must be recognized that any point at which these exemptions are fixed is more or less arbitrary, yet it seems that the lower figures are better suited for a state tax since the great majority of incomes are in the small class and if the amount is raised, much income will thus escape taxation. On the other hand the minimum must not be placed so low that the revenue derived is less than the cost of collection or that the standard of living is seriously impaired.

The minimum exemption is $1000 in Virginia for single persons with an additional $1000 for wife and $400 for

each additional dependent supported by the taxpayer. In addition to these exemptions Virginia also exempts the following forms of income from income tax.

1. Salaries, wages, and other compensation received from the United States by official or employees thereof.

2. Pensions received from the United States or from the state of Virginia.

3. Income received by the United States, the state of Virginia or any political subdivision thereof.

4. The value of property acquired by gift during the year not exceeding the sum of $1000.

5. All inheritance, devises and bequests received during the year which are subject to the inheritance tax of the state.

6. Amounts received through accident or health insurance or under workmans compensation acts.

These exemptions are found in other states as well as Virginia and in addition to the above list, the following exemptions are also found in some states having income tax laws.

1. Income from Federal and State bonds.

2. Income from corporations subject to income tax.

3. Income from farm loans.

4. Income from real estate.

These items comprise the list which are usually exempt from income tax under the laws of the various states. In addition there are also certain items that may be deducted, from income taxable in the various states.

The first deduction from gross income, common to all states having an income tax, is that of the expense of carrying on business or profession of the taxpayer. The items included under this head vary from state to state but usually include, wages and salaries paid, taxes, repairs, depreciations, losses not covered by insurance, worthless debts, and interest on indebtedness. The Virginia income tax law provides for the deduction, in addition to the above named items, of all dividends or profits received from stock, or from an interest in any corporation or co-partnership whose income has already been assessed. Some states also allow the deduction of life insurance premiums from taxable income. A few states allow the deduction of gifts to charitable and religious institutions. New York, North Carolina, Oklahoma, and Oregon allow such deductions where the amount is not in excess of 15% of the net income. In Wisconsin the limit which may be deducted for such gifts is 10% of the net income. The above list of items give the main deductions allowable in the various states. The deduction of taxes paid the state does not include special assessments. Also this deduction is not allowed in the state of New York. These exemptions and deductions present a very important problem in income taxation for several reasons. In the first place they tend to multiply rapidly, one exemption calling for another. In the second place each exemption or deduction allowed, gives increased opportunity to evade taxation. For these reasons it is highly desirable to grant as few as possible yet at the same time

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The next important question which arises in connection with the taxation of incomes is, what shall be the test of liability? There have been several theories advanced on this point but the states having income taxes, have based the test on one of two propositions. The first is, that the domicile or place of residence should be the basis of taxation. On the other hand some states have claimed the right to tax all income derived from within the state regardless of whether the reciptient of such income resides in the state or not. The lack of uniformity on this point leads to injustice, inequalities, discrimination and double taxation. If every state used the same basis this would be largely avoided but as the case stands some state follow one and some the other of these principles and some state follow neither to their limit. The principle of domicile if carried to its logical end would involve the taxation of residents on all income whether derived within or without the state, while income derived from within the state by non-residents would not be subject to taxation. Three states, Delaware, Massachusetts and Mississippi, levy income tax only on residents. The principle of taxing income at the source on the other hand would involve the taxation of residents only on income derived from within the state and the taxation of non-residents on all income derived from within the state. Two states, Arkansas and South Carolina, follow this principle. In Missouri only

the income of residents derived within the state is subject to taxation. In the states of New York, Oklahoma, Oregon and Virginia the income tax is levied not only on the incomes of non-residents derived from within the state but also upon the income of residents from sources outside the state as well as the income of residents derived from within the state.

In addition to this the states of Wisconsin and North Dakota levy income tax not only on the income of non-residents derived from within the state and the income of residents from within the state but also on certain sources of income derived by residents of the state from outside the state. It is evident that in such states neither the principle of domicile or that of source of income is adhered to. Such methods inevitably cause discrimination and result in double taxation. For example an individual lives in New York but owns property or stock in a corporation in some other state. His holdings bear either a property tax or corporation tax, as the case may be, in the state where they are located and in addition the income from that property or dividends from the stock are assessed as income in New York. The result is that two taxes have been paid out of the same income. However if property of the same kind be assessed in New York at the same rate as in the state where the property be located no unjust discrimination exists. However this is seldom the case since rates vary from state to state, and the result is inequality in taxation. But supposing the property to be in some state where there is an income tax under which

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the income of non-residents originating in the state is liable to taxation by the state, the result is that the income pays tax in two commonwealths. If the state where the property be located assesses a property tax also then three taxes will be paid out of the income of such property. Such conditions will occur very often under our modern system where capital moves from state to state and exists in so many diverse forms. Uniformity of method is the first step in the solution of the problem.

The discrimination and double taxation which exists will be largely avoided by either principle, provided all states accept that principle and stay by it. The inconsistency lies in the fact that states like New York and the others named tax all income originating within the state and then further claim the right to tax income which is received by a citizen of New York but derived in some other state. It seems no more than just that since New York claims to tax all income originating within her boundaries irrespective who receive that income, that she would disclaim any right to tax any income originating from any other state. In other words there should exist a reciprocal condition, as between states. It has been suggested as solution of this problem that taxes paid in one state should be given credit in the other state, but this would simply result in a competition between states for the revenue of such incomes as those under consideration. The only fair means, is to find a just basis and then let every state apply it in the same way. What this basis shall the income of non-residents originating in the state is liable to taxation by the state, the result is that the income may [illegible] taxation. If the state where the property is located [illegible] a property tax [illegible] will be paid out of the income of such property. [illegible] condition will [illegible] capital [illegible] from state to state [illegible] in no real [illegible] [illegible]. The [illegible] of [illegible] is the first step in the solution of the problem.

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be is a rather difficult question. It seems on the one hand that if the duty of each citizen to contribute to the government where he resides according to his ability is held to, that the test should be residence or domicile. On the other hand it seems but just that the state should have the right to tax all income produced within its boundaries since it must depend on such income for its revenues. This consideration is further strengthened by the fact that the owner of such property though not a resident must look to the state where the property is located for the protection of his interest and should therefore support the state. The committee appointed by the National Tax Association to draw up a model plan of state taxation reccmmend domicile as the guiding principle in regard to income taxation. Whether domicile or source of income be selected as the ultimate test, the important fact it seems is to have uniformity among the various states and there is a strong probability that whichever principle be accepted, in the long run the loss in revenue caused by that system will tend to be offset by the gains. Thus if residence be accepted as the test, the income going to individuals in other states will tend to be counterbalanced by that coming to residents from other states.

The next problem which arises with an income tax is that of securing an efficient administration. We have already noted the failures of all the early attempts. Of the more recent trials only a few can boast of any notable success, among those which have been in operation long enough to judge their working. While it may be true that defects

in the laws themselves may be to blame in some cases yet the failure in nearly every case may be traced to inefficient administration. A number of causes have contributed to bad administration in the past. In the first place there has been a lack of central control and supervision, largely due to the fact that there was no central authority whose duty it was to oversee and supervise the taxation of incomes. The assessment of incomes has been largely given over to local officials in the past. This constituted another serious defect because in most cases these officials were elective and thus subject to political control. The position was not desirable and the tenure of office short. The recompense being small, the result was that men of inferior ability were very often elected. In many cases such officials have been very lax in their enforcement of the law. The very nature of income makes it easy to conceal and the individual can thereby escape taxation.

The older laws required in most cases that the tax be levied by self-assessment, whereby it was left entirely to the will of the taxpayer to declare his income. Heavy penalties were provided for the failure to do this but no method of information at the source was used, in order to verify the amount of income any person might receive. Under such a form of administration it is no great surprise that the income tax was a failure.

While no perfect system of administration has yet been worked out, progress has been made in some states. At

the same time other states still retain the old methods to some extent. Among these states is Virginia. What little centralization of authority exists in Virginia is in the hands of the Auditor of Public Accounts, but he has practically no authority to compel officials to act. His chief duty is to make out the necessary interrogatories for the assessment of income tax and furnish these to the various commissioners of revenue throughout the state. There exists no central authority whose express duty it is to see that these assessments are carried out or to supervise them in any way. It is the duty of the commissioner of revenue to levy the tax. In so doing he has power only to require the taxpayer to answer such questions and furnish such information as is required in the interrogatories. Here it seems is an important weakness in the system because no single form of interrogatory would be able to secure the necessary information for the assessment of incomes which appear in so many different forms and in so many different ways. Such a system of administration is open to serious objection. In the first place there is practically no central authority to supervise or compel assessment of incomes and in the second place since commissioners of revenue are elected by popular vote, they are thus subject to personal and political pressure. It is true that the Auditor of Public Accounts may report any commissioner to the courts for failure to perform duty but such a step will probably be taken only in case of gross misconduct.

In contrast to the above system some states have

developed a strongly centralized system of administration. Wisconsin has perhaps done more than any other state along this line. However other states have also made some valuable contributions. In Wisconsin the assessment of income tax is performed by special officers known as income tax assessors. These officials are under direct supervision of the state tax commission, which has authority to remove any assessor for incompetancy or failure to perform his duty. These assessors levy the income tax and certify it to the county clerk who makes out the roll and turns it over to Treasurer for collection. In the case of corporations the returns are filed with the tax commission which then assesses the tax. The assessors of income are selected from the civil service so as to be free from political control. They have the power to add to the assessment of any taxpayer, giving notice of the same, whenever they have reason to believe that the returns are erroneous. Provision is made however for the taxpayer to appeal such decision to the Board of Review which is composed of three persons appointed by the tax commission. The action of the board is final except in case of an appeal. In such a case the tax commission is the final authority.

When the forms for the returns on income are given out, blanks are also given out, on which the taxpayer, individual or corporation is required to give the name and address of every one to whom a salary of $700 or over has been paid, also all claims for interest paid on indebtedness together with the name of the person to whom the interest has been paid

This information is classified and furnished to the assessors of income. These blanks serve to show, salaries paid to officers of corporations, the correct deductions for wage, salaries, and dividends paid by the corporation and finally any commission of interest, or wages received by the individual.

The states of New York and Massachusetts also have good systems of administration which are very much like that of Wisconsin. In New York the administration is in the hands of the tax commission and in Massachusetts in the hands of the state tax commissioner. New York also uses a system of information at the source much like that in Wisconsin. In Massachusetts the state is divided into districts and an income assessor appointed for each district by the tax commissioner. Each district assessor has the necessary deputies. An office is located in each district so that the taxpayers may go there to get assistance, information or to pay his tax. Notice is given by placards at the time when the returns on income are due. A system of information at the source is also in use in which corporations making return are required to fill out printed cards which are then filed with the commissioner.

Another objection to income tax as a form of state taxation is found in the fact that the amount of revenue from this source is likely to fluctuate considerable from year to year. In years of depression the amount of revenue may fall far short of what is expected and thus result in a deficit. Such a condition has taken place in both national and state income taxation. According to an article in the Literary

Digest there was a drop in the receipts of the Federal income tax in 1922 of $200,000,000 as compared with that of 1921. Even when we consider that the national budget amounts at present to something over $3,000,000,000 yet the deduction in one year of $200,000,000 is not unimportant since it amounts to about one-fifteenth of the entire budget. The same thing has taken place in Virginia recently. The receipts from income tax in Virginia in 1922 were approximately $2,500,000 whereas in 1923 the yield was only $1,100,000. During the same time the state treasury faced a deficit of approximately $1,500,000. It might be held that the returns in prosperous years would tend to offset the lack of yield in times of depression. But on the other hand the increased yield in times of prosperity may also offer an opportunity to increase state expenditure unduly.

This problem might be solved to some extent by creating a system which would to some extent be flexible, by providing means by which the rates might be raised slightly when the yield was expected to be small. Such authority might be lodged in the tax commission with privilege of using it only in the face of a probable deficit. Such a plan would be open to two objections. In the first place it would place great power in the hands of the tax commission. The upper limit however should be fixed by the law so that the commission could not go beyond it. Another objection would be, that it would tend to increase the burden of taxation when the taxpayer was least able to bear it. This objection applies however to the

general property tax which many states use at present. The increased burden by such means under the income tax would be no greater than under the present system of the general property tax and in addition it would impose the burden in proportion to the ability to pay whereas the general property tax fails to do this in many cases. It remains a fact however that no state so far has found any solution to this problem. So far the attention of the legislator has been directed to other problems and this question has been given little thought.

The final question remaining to be considered is that of the probable effects of industry of an income tax. The fact that practically the majority of states use progressive rates would seem to point to a discrimination against large incomes. Progressive rates are justified on the ground that the large income means a greater ability to pay than a small income and that this ability increases in a greater proportion than the increase in income. The problem is, will not this heavier tax on large incomes tend to reduce these incomes? It must be remembered that the savings out of which come the capital for future production come very largely from the class of the larger incomes. Anything which reduces savings and thus affects the future supply of capital will reduce the sources from which the state can draw revenue in the future. However with the mildness of progression in use at present in most state income tax laws there is not so much danger of seriously decreasing the incomes of the taxpayer. The majority of states use rates of six percent or under and these rates do not de-

crease savings to such an extent as to impair the accumulation of capital.

A more serious objection than that impairing the accumulation of capital for use in future production, is found in the danger of driving capital out of the state into some other state where it is not so burdened. Just how far this will take place is very uncertain and will depend on several things.

In the first place where domocile is made the test of liability it will be of no value to shift the employment of capital to some other jurisdiction, since the income will still be subject to taxation. If conditions elsewhere offered sufficient inducement the owner of capital might remove his residence from the state. This will depend on two things, namely the opportunity for profits elsewhere and the amount of taxation in other states. While no absolute conclusion can be drawn on this point, yet it seems certain that as time passes, more states will adopt income tax laws and these laws will probably tend to become more uniform so that these difficulties will probably disappear to a large extent. Yet at present it would seem wise at least for states adopting an income tax to be careful not to raise the rates too far out of proportion to those of other states lest it result in driving capital out of the state and thus hinder the economic development of the state. South Carolina is the only state at present with rates steeply graduated and even here the highest rate will affect very few incomes so that it will probably not have very unde-

sirable consequences. But at the same time it is these larger incomes with the higher rates of taxation, which produce the large part of the returns in the case of the income tax. Therefore it is almost imperative that the various states adopting income tax should cooperate to a considerable degree not only in regard to the principle adopted for liability but also in regard to the rates established. Such cooperation seems almost essential to secure a satisfactory working of the income tax as a source of state taxation.

RELATION TO OTHER FORMS OF TAXATION. Another important problem which arises in connection with income taxation is that of its relation to other forms of state taxation. This relation is particularly important in respect to the general property tax, since this tax, both in the past and at present, forms the foundation of the state tax system in practically every state. The property tax shows little tendency to disappear from our system, but as Professor Lutz remarked before the National Tax Association in 1920, that it is, in most places, not only far from the scrap heap but in many places seems to be taking on a new lease of life in its most undesirable form. The question involved in this relationship resolves itself into a choice between two alternative methods to a considerable extent. In the first place the income tax may be used to supplement the property tax and in this case it involves the problem of coordinating the two. In the second place the income tax may be made to replace the property tax. Either of these two plans presents its own peculiar difficulties. From the standpoint

of justice and equality it seems that the income tax should supplant the property tax because of the great inequalities that exist in the latter. But at the same time the income tax as the chief source of state taxation is open to some objections. In the first place it violates the canon of universality in taxation which holds that it is the duty of every citizen to contribute at least something to the support of the government under which he lives and from which he receives benefits. It is practically a universal practice under the income tax to exempt under a certain amount from income taxation. The reasons for exempting these small incomes, as has already been pointed out, lies in the fact that the revenue derived from such incomes, to which a very low rate is usually applied, is not sufficient to pay the cost of collection. At the same time it is held that a certain minimum for subsistence should at all times be exempt from taxation. Under such conditions a fairly large number of citizens escape direct taxation. It is further considered that every citizen should make some direct contribution to the government in order to insure his interest in the state. But under a system where the income tax is the chief source of state revenue some method must be devised to reach those citizens who now pay tax under the system of the general property tax but who would escape taxation under the income tax.

A further objection to replacing the property tax with the income tax is found in the fact that the revenue derived is likely to fluctuate widely from year to year depending on business conditions within the state. The needs of the

state, barring extraordinary expenditures, is fairly uniform from year to year, therefore the revenue would tend to be inadequate in times of industrial and business depressions. On the other hand it must be pointed out that the state ought to retrench its expenditure somewhat during such periods. However the fact remains that where the income tax replaces the property tax some measures must be taken to meet the problem of fluctuation in the amount of revenue derived from year to year.

The other alternative, that of using the income tax to supplement the property tax is the method pursued by practically all the states which have at present adopted the income tax. This method however involves the problem of coordinating the two forms of taxation. This problem arises in connection with the double taxation, which such a method results in. To levy a tax on income and also on the property from which such income is derived is plainly a case of double taxation. But as Professor Seligman has pointed out such double taxation is unjust only when certain kinds of property are discriminated against, as is the case where the tax is levied against both the property and the income of the same property, while other forms of property escape taxation. Where all forms of property are subjected equally to taxation along with income there is no injustice, but the result is that a higher proportion of the income is taken for purposes of revenue in each case. However it has already been pointed out that the equal taxation of all forms of property under the general property tax

is almost an impossibility. In view of this fact a number of states, notably Massachusetts and Wisconsin have done away with certain forms of the general property tax. One of the strong points in favor of the income tax is its use as a substitute for the property tax on intangibles which has broken down. At the same time the income tax cannot be used along with the property tax on intangibles. Professor Lutz says, that it is a foregone conclusion that the state income tax will fail more or less completely, if set up along side of the property tax on intangibles. But if intangibles be exempted from the property tax while it is retained, along with the income tax, on other forms of property, the result is not only an unjust discrimination against such forms of property, but it is also a violation of the principle that unearned income should be taxed at a higher rate than earned income. Therefore where the income tax is set up along side of the property tax some method must be devised to avoid any such discrimination. Fortunately several states have taken steps toward the solution of the problem. Wisconsin was the first state to recognize this fact. The property tax on intangibles was abolished in that state when the income tax was instituted. In order to avoid any unjust discrimination against other forms of property, a plan known as the tax offset was provided whereby the taxpayer was allowed to deduct taxes paid on personal property from the amount of tax due on his income. This plan seems to have several advantages. In the first place it is almost an impossibility. In view of this fact a number of states, notably Massachusetts and Connecticut have done away with certain forms of the general property tax. One of the strong points in favor of the income tax is its use as a substitute for the property tax on the intangible [illegible] broken down. At the same time the income tax cannot be made along with the property tax on intangibles. [illegible] that it is a [illegible] question [illegible] will fall more or less [illegible] the property tax on intangibles. [illegible] exempted from the property tax while it is [illegible], [illegible] same way, in other forms of property, the result is not only an unjust discrimination against other forms of property, but it is also a violation of the principle that [illegible] income should be taxed at a higher rate than earned income. [illegible] [illegible] method [illegible] tion. [illegible] [illegible] of the [illegible]. [illegible] [illegible] In order to avoid any unjust discrimination against other forms of property, [illegible] [illegible] [illegible] makes income the basis of tax paying ability in all cases except those incomes which are below the exemption line. This is in harmony with the principle that income is the true measure of ability to pay. In the second place it still reaches those individuals, whose incomes are below the exemption line, through the property tax. This plan has since been followed by several other states. Both North Dakota and New Mexico permit the deduction of all state and local taxes paid on personal property, from the amount of income tax due. The constitution of North Carolina which was amended in 1920 so as to permit the use of an income tax in that state, specifically provides that no income tax shall be levied against the income from property on which a property tax has been paid. This method avoids any discrimination against any one form of property but at the same time it has certain drawbacks in operation.

Professor Lutz points out that the loss in revenue from such exemptions must be made up for by higher rates and by steeper progression so as to secure the necessary revenue. There must also take place under this system a double assessment since both income and property must be assessed while the tax in reality amounts to only an income tax where the incomes are above the exemption limit, and to a property tax where the income is below the exemption allowed by the law. This double assessment tends to increase the cost of administration somewhat.

It would seem however that this problem would be

eliminated under a system of separation or segregation, which is now in use in quite a few states. Under this system where the property tax is left to the localities and the income tax is left to the state, the relation to the property tax does not arise.

The problem of double taxation also arises where the incomes of corporations are subject to income tax while their property is subject to the property tax. While most corporations do not own so much real estate, yet what they hold is usually assessed rather high because of the improvements on it. The same considerations as were advanced for the personal income tax in this respect will apply here also.

The question of double taxation also arises in connection with other forms of taxation, such as the franchise tax etc. Indeed it may seem that the only way to avoid such problems is to make the income tax the sole source of revenue. This would involve another danger however. The state system of taxation must furnish revenue and to secure adequate revenue the system must have a broad base says Professor Seligman. If incomes were made the only object of taxation some method to insure adequacy must be devised.

CONCLUSIONS:- In drawing conclusions it should be remembered that one cannot lay down any hard and fast rules on such a question as that under consideration. Tendencies can be pointed out, and suggestions made, but some new development in methods of taxation may show the problem up in an entirely different light at any time. Methods which will apply in one

state will not apply in another, because of different conditions in each state. Therefore each state will have to work out its own problems in harmony with its particular needs and conditions. However a few general considerations applying to all states may be noted.

In the first place the ability of the income tax as a source of state revenue has been amply demonstrated. The experience of such states as Wisconsin, New York and Massachusetts has shown that the income tax can be made to produce a large revenue and that the cost of collection is no greater than in the case of other forms of taxation. From the theoretic point of view the income tax is the most logical form of taxation and it would seem that it should succeed all other forms. However in practice it presents some problems which make it doubtful whether it will replace other forms entirely, at least for some time in the future. Present efforts are directed along the line of using the income tax to supplement other forms of state taxation. This raises the problem of coordinating it with other forms but this problem has been attacked and some valuable results have been obtained.

The substitution of the income tax for the property tax seems too radical a step for most states at present, yet in some states where the income tax has been in operation for some time there is strong sentiment to abandon the property tax entirely. This is notably true of Wisconsin.

Such changes will be facilitated, as the problems of the income tax are gradually solved, and it is probably, not ments will not apply in entirety, because of different condi- tions in each state. Therefore each state will have to work out its own problems in harmony with its particular needs and conditions. However a few general considerations applying to all states may be noted.

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The administration of the income tax for the [illegible] [illegible] the [illegible] a [illegible] proper [illegible] and in [illegible] where the [illegible] has been in operation for some time there is [illegible] to [illegible] the property the [illegible]. This is [illegible] true of Wisconsin.

Each state will [illegible], as the [illegible] of the income tax are [illegible], and it is [illegible], but going too far to predict that in the future, the income tax may replace the property tax as the basis of state taxation. The property tax in turn may be either done away with, or given over to the use of the local units of government.

The utter lack of uniformity in the income tax laws adopted by the different states has already been pointed out. It seems that some cooperation on the part of the different states employing the income tax in regard to the test of liability, the rates employed, and the methods of assessment would be of great value in bringing about a successful operation of the income tax. It is almost imperative that some uniform principle be adopted in regard to the test of liability, if justice is maintained and double taxation avoided. What this principle should be, it is somewhat difficult to say. Both the taxation of income at the source and taxation according to residence is open to objection. Professor Seligman has advanced a principle by which he proposes to divide the tax between the state of residence and the state where it originates, on the basis of political and economic allegiance. This idea seems somewhat indefinite and would require joint action on the part of the various states concerned. Such action would be difficult to secure. Moreover any line of division that might be drawn, under such a principle would be more or less arbitrary because there is no way by which the responsibility of the individual to each state can be measured with any exactness. On the whole, the taxation of income at the source seems perhaps the fairest

solution of the whole problem.

Under this principle the state would secure a portion of every income, and only of such income as was produced within the state. The essential thing however, regardless of what principle is adopted, is to secure uniformity as between states. It is to be hoped that the work of the National Tax Association will serve as a unifying force along this line.

Another fact which is noticeable in the study of present income tax laws is the need for revision in many states. The laws which are now in force are antiquated and should be revised so as to contain such new provisions as have been found worth while by states which have more recently adopted the income tax. The state of Virginia furnishes a good example of this fact. While the income tax law in Virginia was revised to some extent in 1914 yet many desirable features were left out, that might well be included. Among these features are the administration by a central tax commission, appointment of income tax assessors by the tax commission, the use of graduated rates, and the provision for some method of information at the source. With such changes the income tax in Virginia should be much more productive of revenue than the present system has been.

Finally it should be remembered, that while the income tax presents a more just basis for taxation than the general property tax which is now in use, it is not a cure for all the evils of taxation. It presents some peculiar problems which will necessitate considerable care to bring about their solution. Careful provision for the determination of taxable

income must be worked out. Here we would agree with Professor Lutz that one of the most important needs is a more adequate return of the income from all sources whether taxable or not.

Care must also be taken to provide the proper administrative machinery. The majority of failures in the past have been due to lack of administrative control. The administration must be placed in the hands of some central authority, with ample powers to see that the work is done efficiently. The assessors should be appointed by this authority and never be elective. The central authority should have power to supervise assessors and to remove any assessor for neglect of duty. The assessor should be given such tenure of office and salary as is needed to secure competent men. They must be given the necessary power, such as the right to examine public records, tax records etc., to carry out their duties in an efficient manner. The Massachusetts plan of dividing up the state into districts is excellent. By giving a district to each assessor, who in turn maintains an office therein, the taxpayer has a source to which he can go for information, and the assessor has the opportunity of getting thoroughly acquainted with his territory, and is enabled to keep in personal touch with the taxpayer. Some system of information at the source is also essential to the efficient administration of the income tax. But with a carefully worked out law and provision for proper administration there is no reason why the income tax should not be a satisfactory source of state revenue.

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Care must also be taken to provide the proper administrative machinery. The majority of failures in the past have been due to lack of administrative control. The administration must be placed in the hands of some central authority, with ample power to see that the work is done efficiently. The assessors should be appointed by this authority and never be elective. The central authority should have power to supervise assessors and to remove any assessor for neglect of duty. The assessors should be given such tenure of office and salary as is needed to secure competent men. They must be given the necessary powers, such as the right to examine public records, tax records etc., to carry out their duties in an efficient manner. The recommendation made of dividing up the state into districts is excellent. By placing a district in each assessor, who is then made responsible for this, the taxpayer has a person to whom he can go for information, and the assessor has the opportunity of getting thoroughly acquainted with his territory, and is enabled to keep in closer touch with the taxpayer. Much of the success of the income tax also depends on the efficient administration of the income tax. But with a carefully worked out law and provision for proper administration there is no reason why the income tax should not be a satisfactory source of state revenue.

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