such essentially interchangeable terms as "fairness," "justice," and "equity," presents great difficulties.

1. On one aspect of equity there will be a consensus: "Every taxpayer shall be treated according to legal rules which apply equally to all taxpayers in the same class." Fairness requires that there be no prejudice, whether by accident or design, in the application or administration of the law.

2. Widespread agreement can be expected on another concept — horizontal equity. "Equals shall be treated equally." Everyone on the same income level or consuming about the same things, and otherwise in essentially similar circumstances, shall bear the same portion of the expense of government. When their circumstances differ in ways that are significant for the sharing of the costs of government — size of family or total of charitable contributions, for example — fairness requires that tax loads differ.

3. The difficult problems that then arise are those which involve vertical equity. How much of what differences will warrant how much difference in tax? In answering this question, little consensus will be found — except that the unequal treatment of taxpayers must rest on reasonable, not capricious, bases.

Throughout much of the Western world there has grown up a general notion that tax burdens should reflect "ability to pay." This concept, however, is about as unclear as "fairness." There is also wide acceptance of the view that the tax system should be progressive, i.e., the amount of tax payable expressed as a percentage of income rises more rapidly than income. But what basis is there for deciding how much in taxes it is fair to demand from the family with an income of $10,000 than from the almost similarly situated family with $9,800 or the very differently situated family with $8,000 or $12,000? Ardent supporters of progression as a device for discriminating fairly may disagree strongly on the fairness of a given set of rates. A scale of progressive rates may be so steep as to be unfair, but when?

Some advocates of progression make much of the point that reducing economic inequality through taxation is socially desirable. Whatever reasons can be cited for this argument in judging Federal taxes, it cannot have great weight at the state level and even less for local governments. Imagine, for example, a state trying to discriminate against upper income and wealth groups heavily enough to reduce inequality significantly. A gradual exodus of people of wealth and talent would largely defeat the attempt as they moved to states with lower tax rates on large incomes. Movement from one locality to another would be even easier as a rule.

Benefits from Government Spending as a Basis for Taxation. Another basis for differentiating tax burdens to achieve fairness may be the government services received — the benefit principle. Although governmental spending is presumably done to further the general public interest, individuals as such do benefit from some expenditures. Some individuals benefit more than others. On occasion, these benefits can serve as an equitable basis for imposing a tax.

Motor fuel and license taxes and the employee part of the (Federal) Social Security payroll taxes are commonly justified on the benefit basis. Perhaps more significant is another aspect of benefit. Residents of some communities pay higher taxes than residents of others because of differences in the government
services received. The same applies at the state level. Decentralization in government offers more opportunity than does a centralized system for people to decide freely whether the benefits of certain public expenditures are worth their cost.

**Shifting Taxes to People Outside the State.** Some states and localities try to take advantage of the possibilities of passing part of their tax burden to outsiders. One kind of opportunity arises from the deductibility provided in Federal tax laws. Rational self-interest requires every state and locality to consider carefully all the opportunities Congress allows. A second type of opportunity to shift burdens to outsiders appears chiefly in taxes which fall initially on businesses. Non-residents also pay part of the individual income and inheritance and estate taxes collected by many states. Visiting tourists pay sales and excise taxes. In general, however, the ability to shift taxes to residents of other states is limited. Businesses and individuals who are asked to pay taxes for which they get no benefits can be expected to try to adjust their affairs to escape the burden.

**Other Considerations Affecting the Distribution of Tax Burdens.** Five more points deserve mention. (1) Differences in taxes are justified in some cases by the desire to influence production and consumption in the interest of the general welfare—philanthropic exemptions, for example, high tax rates on whiskey are another. (2) Conclusions about how taxes are in fact shared among members of the community, state, or nation are always tentative. Often, especially in the case of taxes on business, the payer tries to shift the tax to others, such as customers. The results, however, are by no means clear. (3) The inequality of political power can lead to results which have little or no justification in equity. The scale of progression of an income tax, for example, may rest in part upon the fact that few voters are to be found high in the income scale. (4) An ideal tax would create no serious hardship. In the real world, unfortunately, a tax which is generally deserving of approval may produce some hard cases which merit attention. But a tax designed specifically to meet one and another unusual situation will have unwelcome results as the law applies more broadly with detailed provisions not really appropriate for wide application. (5) Actions of the past, including those embodied in constitutions and city charters, limit today's opportunities.

**Economic Efficiency**

**Keeping Allocation Distortions at a Minimum.** Efficiency in the allocation of productive resources (human and material) is important in advancing the general welfare. Taxes affect resource allocation. The general objective would be taxes which hinder as little as possible the efficient operation of free markets. As a general principle, best results are to be expected if taxes are neutral or impartial in their effects on resource allocation—among private industries, regions, occupations, methods of operation, forms of organization, and so on.

The repressive and allocative effects of a tax should interfere as little as possible with the accomplishment of governmental objectives of the public. For example, we can conclude from spending on highways that the improvement of transportation is a goal of public policy. Then taxes which burden railroads will probably impede achievement of the broad objective of the expenditure to make transportation better.
Where for some persuasive reason interference with the market economy seems likely to serve the public interest, tax discriminations may be devised to alter resource allocation. Taxes may, on occasion, serve a useful regulatory purpose — though, of course, they may also regulate harmfully.

"Business" as an Object of Taxation. Although "business" is a favorite object of taxation, one can well ask, "Why?" Business is our major agency for organizing to produce — for allocating productive capacity and its use and for undertaking economic growth. Businesses are groups of people seeking to benefit themselves by serving others. Taxes are not likely to help business serve efficiently in producing.

Broadly, the public interest calls for each business (1) to turn out products or services which are wanted more than something else, as reflected in freely made consumer decisions expressed in the market or through governmental agencies, and (2) to use methods which economize on labor, materials, capital, and other "inputs" according to their relative scarcity and productivity.

Taxes on business can hamper the process by which consumers indicate their desires because the tax element in prices of goods and services will not be uniform. And in production a business has an incentive to save on taxes. Unfortunately, in adopting methods which cut the tax bill, it may not operate more efficiently in the sense of less labor or fewer materials per unit of output. A company, in fact, may wisely adopt methods which are inherently second choice because the artificial factor of taxes makes such methods best under the circumstances.

The broad public interest would be advanced by generally freeing business decisions from most tax considerations. Exceptions may appear if business as such puts government to special costs — or receives special benefits from expenditures. Not many such cases can be cited. Today, in contrast with the days when our economy was predominantly agricultural, those persons who make decisions about where to produce have some choice about where to locate. Taxes and governmental services are among the factors which influence decisions on business location. High state-local taxes are certainly not a favorable element unless they finance governmental services which either facilitate economic activity or appeal to the people who must foot the bill.

Influence on the Demand for Government Service. In free markets it is prices which make buyers aware of cost and which induce economizing. Is there anything comparable as regards government spending?

Sometimes a government may charge in a way that influences the quantity demanded, for water or parking space. The charge not only collects revenue; it can also reduce the need for government to spend to provide the function. States and localities have some opportunities to use what is essentially pricing for the dual objective of getting revenue and reducing expenditure.

Taxes also have a job to do in alerting citizens to the costs of government. Taxes which make the public aware of what it is paying for governmental services can help in comparing the worth of the services received with the money sacrificed to pay for them. The clearer each citizen's recognition of the taxes he pays, the greater the likelihood that the sense of political responsibility will develop.
Certainty. Tax statutes, regulations, and administration should be reasonably stable in their basic elements. Otherwise, uncertainty about tax laws adds to the difficulties of business and personal planning for the future. Although it is not necessarily true that “an old tax is a good tax,” usually the economy will have adjusted to it. A considerable degree of certainty in the tax system is desirable, especially when taxes are as heavy as today; otherwise, decision making becomes needlessly complicated, and efficiency suffers.

Administration and Compliance. The administration of a tax involves costs for the government and compliance burdens taxpayers. Although such expenses are necessary, the effects produce nothing desirable in themselves. Consequently, it is preferable to keep the costs of the government and of the taxpayer as low as is consistent with good administration. But enough should be spent to assure good quality, for if tax administration is poor, both inequity and loss of revenue result.

To sum up, a tax, and a tax system, must be judged on the basis of several criteria, all of which deserve consideration. Yet these criteria differ in their very natures and essence; inevitably, therefore, difficulties arise in trying to compare and balance their relative importance. Appraisals of tax systems will differ when, as is to be expected, individuals weigh the criteria differently. And, of course, the “facts,” such as the shifting of a tax, are rarely clear; differences in estimates of the facts will lead to disagreement about the relative merits of taxes and tax systems. Moreover, significant differences in the actual implementation of each kind of tax are to be found from one state to another, and within states from one locality to another.
State and Local Taxes

State governments once relied primarily upon the property tax, discussed later. Gradually, however, as local revenue needs rose during the period from World War I into the 1930's, states let local governments have more and more of the revenue from the property tax. The states then turned to other tax sources to pay for rising expenditures. Table 8 shows the relative importance of major types of state taxes since 1922. Table 9 shows for 1965 the major sources of tax revenue for all states combined and the number imposing each tax.

State Taxes on Purchases
States get most of their revenue from taxes on purchases, i.e., consumption.

1. State retail sales taxes date from the 1930's. Today most Americans live where such taxes exist and know something about them from experience. The laws differ, of course, not only in rates, which go from 2 to 5 percent, but also in the range of goods and services taxed. Although sometimes termed "general," all of these taxes exempt such important types of consumer spending as rent (but not the materials used to build houses), interest, and medical and dental services. A few exempt food. Coverage of services (laundry, repairs, electricity, etc.) varies considerably.

Most states apply the tax to some goods and services bought by businesses.

Table 8
Percentage Distribution of State Tax Collections by Source
Selected Years, 1922 – 1966

<table>
<thead>
<tr>
<th>Year</th>
<th>General sales, use, or gross receipts</th>
<th>Motor vehicle fuels</th>
<th>Tobacco, alcoholic beverages sales and licenses</th>
<th>Motor vehicle and operator's licenses</th>
<th>Individual and corporation income</th>
<th>Property</th>
<th>Other(a)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1922</td>
<td>14</td>
<td>15.1</td>
<td>10.6</td>
<td>9.5</td>
<td>7.6</td>
<td>7.6</td>
<td>21.4</td>
<td>6.8</td>
</tr>
<tr>
<td>1927</td>
<td>16.1</td>
<td>18.7</td>
<td>18.7</td>
<td>7.8</td>
<td>7.8</td>
<td>7.8</td>
<td>18.6</td>
<td>6.0</td>
</tr>
<tr>
<td>1936</td>
<td>26.2</td>
<td>8.0</td>
<td>13.8</td>
<td>10.2</td>
<td>8.7</td>
<td>8.7</td>
<td>19.3</td>
<td>6.0</td>
</tr>
<tr>
<td>1940</td>
<td>25.3</td>
<td>10.6</td>
<td>11.7</td>
<td>9.5</td>
<td>7.8</td>
<td>7.8</td>
<td>18.6</td>
<td>6.0</td>
</tr>
<tr>
<td>1945</td>
<td>16.0</td>
<td>12.1</td>
<td>9.5</td>
<td>8.7</td>
<td>7.8</td>
<td>7.8</td>
<td>18.6</td>
<td>6.0</td>
</tr>
<tr>
<td>1950</td>
<td>19.5</td>
<td>11.5</td>
<td>9.5</td>
<td>8.7</td>
<td>7.8</td>
<td>7.8</td>
<td>18.6</td>
<td>6.0</td>
</tr>
<tr>
<td>1955</td>
<td>20.3</td>
<td>8.7</td>
<td>10.2</td>
<td>7.8</td>
<td>3.6</td>
<td>3.6</td>
<td>18.6</td>
<td>6.0</td>
</tr>
<tr>
<td>1960</td>
<td>18.5</td>
<td>9.2</td>
<td>8.7</td>
<td>8.7</td>
<td>3.4</td>
<td>3.4</td>
<td>17.5</td>
<td>6.0</td>
</tr>
<tr>
<td>1965</td>
<td>16.5</td>
<td>8.9</td>
<td>7.7</td>
<td>7.7</td>
<td>2.9</td>
<td>2.9</td>
<td>16.8</td>
<td>6.0</td>
</tr>
<tr>
<td>1966</td>
<td>15.7</td>
<td>9.0</td>
<td>7.6</td>
<td>7.6</td>
<td>2.8</td>
<td>2.8</td>
<td>16.5</td>
<td>6.0</td>
</tr>
</tbody>
</table>

Details may not add to totals because of rounding.

a. Includes death and gift, severance, and other taxes. Does not include payroll taxes for unemployment benefits.

Source: Department of Commerce, Bureau of the Census.
for use in production. To this extent, therefore, these taxes depart from a basic principle of taxing consumption only once and at the retail stage.\(^1\) All states exempt sales delivered outside the state, but they back up their sales taxes by use taxes on items purchased outside the state and brought in for use. Enforcement is difficult, however, except for autos (which must get a license in the buyer's state) and items sent by mail or shipments for which there is a record. In cases of the latter type, the selling company, even though out of the state, can often be held responsible for collecting the tax.

Revenue yield from sales taxes can be "large," rising as national income goes up and with only moderate cyclical fluctuation. Administration and compliance compare favorably (per dollar of revenue) with other tax sources but, of course, do create problems for the businesses which must do the work. Convenience for the taxpayer is high in that payments are made frequently and in small amounts incidental to everyday transactions. Whether the tax does much to increase awareness of cost of government is difficult to judge. Does the tax lead to undesirable modifications in ways of doing business and thus impose indirect burdens on the economy? Any such effects will generally be moderate or negligible as long as tax rates remain in the 3% range, but exceptions may be more numerous than we know.

On grounds of equity, judgments differ. Some sales tax falls on the lowest income consumers; as noted later, however, the burden is generally proportional for most of the public, especially over a period of years during which exceptional experiences and differences in the life cycle can "average out." There is some discrimination among families on the basis of patterns of consumption, e.g., proportions for exempt services.

2. "Highway taxes," those on motor fuels (gasoline) and license fees on autos, trucks, and drivers, have a history which began with the need to keep control over vehicles for purposes of policing. Licenses subsequently became a source of revenue. Then in the 1920's states found in gasoline taxes a source of dollars which helped meet costs of

<table>
<thead>
<tr>
<th>Table 9</th>
<th>State Tax Revenue by Source and Number of States Imposing Tax</th>
<th>1965</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax revenue (millions)</td>
<td>Number of states using tax</td>
<td></td>
</tr>
<tr>
<td>Total Taxes(^{(a)})</td>
<td>$26,126.1</td>
<td></td>
</tr>
<tr>
<td>General sales and gross receipts taxes</td>
<td>6,711.3</td>
<td>37</td>
</tr>
<tr>
<td>Selective sales</td>
<td>8,347.5</td>
<td>(b)</td>
</tr>
<tr>
<td>Licenses</td>
<td>3,217.5</td>
<td>(c)</td>
</tr>
<tr>
<td>Individual income</td>
<td>3,657.5</td>
<td>36</td>
</tr>
<tr>
<td>Corporation net income</td>
<td>1,929.0</td>
<td>38</td>
</tr>
<tr>
<td>Property</td>
<td>766.2</td>
<td>47</td>
</tr>
<tr>
<td>Death and gift</td>
<td>731.4</td>
<td>49</td>
</tr>
<tr>
<td>Severance</td>
<td>503.4</td>
<td>29</td>
</tr>
<tr>
<td>Poll</td>
<td>8.6</td>
<td>9</td>
</tr>
<tr>
<td>Document and stock transfer</td>
<td>149.4</td>
<td>14</td>
</tr>
<tr>
<td>Other</td>
<td>104.5</td>
<td>10</td>
</tr>
</tbody>
</table>

\(^{a}\) Does not include $2,994 million in unemployment compensation taxes collected in 50 states.

\(^{b}\) Includes: Motor fuels—50 states; alcoholic beverages—50; tobacco products—48; insurance—50; public utilities—39; pari-mutuels—27; amusements—29. Also includes other selective sales taxes used by 29 states.

\(^{c}\) Includes: Motor vehicles license tax—50; motor vehicle operators—49; corporations in general—50; public utilities—32; alcoholic beverages—49; amusements—36; occupations and businesses—50; hunting and fishing—50. Also includes other license taxes used by 40 states.

\(^{1}\) If a tax applies, first, to purchases by businesses for use in production and then, secondly, to the products sold to the consumer, there is double taxation in the sense that the same value is taxed twice. Such duplication runs counter to the principle of taxing on the basis of retail value.
highway expansion. Today, both license and motor fuel revenues are generally “earmarked” for spending on highways, streets, and related facilities. These taxes, therefore, are closely related to benefits provided for those who bear the burden. Of course, the benefit relationship between the tax on a tankful of gasoline and the streets and highways available for driving cannot be so close as that existing between the price of a pair of shoes and the benefit from wearing them. Overall, however, the revenues support spending which gives direct aid to those who pay. On grounds of equity and economic efficiency, these taxes rate highly. In general, their administration raises little difficulty.

3. Liquor and tobacco taxes can be effective revenue producers, as they are for the Federal government and in most states; 16 states obtain revenue from sale of liquor as profit from state-operated stores. Tax revenue on cigarettes became significant in a few states in the 1930’s and then spread rapidly after the war. Despite the apparent unfairness of taxes which fall much more heavily on some persons than on others — those who smoke and drink alcoholic beverages compared with those who abstain — state legislators have put increasingly heavy burdens upon consumers of these products. Apparently there is considerable public feeling that consumption of liquor and tobacco should be discouraged or that persons who spend on such nonnecessities have special ability to pay for cost of government. Rates per package of cigarettes have risen to 10 cents or more in seven states and eight cents or more in 27 states (added to the Federal tax of eight cents). However, state tax rates on spirits and beer, though not so generally on wine, are lower than Federal.

4. A somewhat miscellaneous group of state taxes on consumption includes levies on insurance premiums (on the average around 2 percent), public utility services, racing, and occasionally other things. Space does not permit description or evaluation of these taxes, which can differ widely from state to state.

Income Taxes

Four-fifths of the states tax personal and corporation income. A few such taxes go back 50 years or so, but the majority were first imposed in the 1930’s. The individual states developed income tax laws which resemble each other in some respects while differing in others. For example, differences in the definition of “income” have been numerous. Recently, however, states have modified their laws, especially as applied to the tax on individual income, to conform to Federal law in the definition of taxable income (except for personal exemptions plus details which affect only a minority of taxpayers). The taxpayer’s problems have been simplified, and states find it easier to cooperate with Federal officials in administering income tax laws.

Businesses, however, still find that when they operate in many states they must compute tax on the basis of several concepts of profit. Moreover, states use different bases for designating how big a fraction of a corporation’s nationwide earnings are to be taxed by the state. In 1966 Congress held hearings (but did not vote) on proposals to induce states

2. State-local spending on streets and highways (in excess of outlays paid for by Federal funds) were $8.2 billion in 1964-65; motor fuel and license tax revenues were $6.5 billion.

3. The taxes in this group are frequently imposed on the supplier and thus hidden from the consumer. Though perhaps labeled “business taxes,” the burden will generally rest on the consumer because the company’s prices will be higher than if there were no tax.
to apply more nearly uniform methods.

Most state personal income tax rate schedules are progressive. For example, California's rates range from one to seven percent, New York's from two to 10 percent. Personal exemptions are $600 a person in 11 states (the same as the Federal); several states allow smaller exemptions per dependent, e.g., $400 but a substantial deduction for the family head, e.g., $2000. These taxes probably conform fairly well to popular concepts of fairness. They exempt a minimum of income and thus, as distinguished from consumption taxes, tend to favor large families of low income. Administration and compliance vary greatly in quality and expense. In 33 states the tax is withheld from wages.

Tax rates on corporation earnings are most often from two to six percent of the income estimated to have been earned in the state. The desire to avoid creating an unfavorable climate for business — and interstate competition for industry has grown increasingly keen — has operated as a restraint on states in raising corporation tax rates.

**Payroll, Inheritance, and Other State Taxes**

Every state, as a result of Federal induction embodied in the Social Security Act of 1935, taxes most employers to pay for unemployment benefits. The tax on each company will depend somewhat upon the amount of unemployment among its employees. The rates are generally between 2.7 and 4 percent of the first $3,000 or more of each person's annual pay; for some employers this expense is large in relation to profit, while for others the cost is small.  

Every state but Nevada taxes property changing hands at death (less exemptions). Most of these state taxes are of the inheritance form, i.e., based on the amounts received by each heir. A few death taxes, however, follow the Federal form, the estate tax, which applies to the entire wealth above some exemption, regardless of the number and relation of heirs. Rates are progressive and vary a good deal from one state to another. The Federal government allows all or most of the state tax as a credit against Federal tax if any is due, thus eliminating much of any difference from one state to another. Inheritance and estate taxes provide elements of progression in state tax systems. Death taxes are highly complex, and the amount actually due can be altered greatly by careful planning before death. Gift taxes are imposed by a dozen states. The objective is to get some revenue from transfers of property which escape tax at the death of the donor because the wealth is no longer in his estate.

A few states get revenue from severance taxes — based on the extraction of oil or some other natural resource. Corporations as such are frequently taxed on bases not closely tied to income, such as the value of capital stock outstanding. Such taxes are rarely large revenue producers.

**Local Property Taxes**

The major source of local tax revenue has been, and remains, the property tax.

For the country as a whole, per capita

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4. In 1965, 19 states allowed individuals to deduct Federal tax in figuring taxable income. In such cases the burden of state tax on larger incomes will be less than a look at the tax rates will suggest.

5. State taxes differ greatly in almost all respects, President Johnson has urged Congress to increase the tax rate on employers, to make the tax apply to more of total wages, and to modify other features which would also raise the cost to employers. Benefit payments to the unemployed would go up. Employers must pay Federal tax 0.4 percent in addition to state tax.
property taxes (including the relatively small amounts raised by the states) in 1965 were $118. Table 10 shows per capita property taxes in selected states in 1965. Table 11, which shows property tax revenues in relation to Net National Product for a few years, indicates that these taxes have gradually increased in their relative importance since 1950. In that year they represented 2.7 percent of NNP; by 1965 they were 3.7 percent.

Coverage. From community to community, and from state to state, the tax differs significantly — in the general structure as laid down in the law and also in the actual administration.

The tax is not a tax on a person’s wealth, either gross or net. Less than a century ago, it is true, there was a general belief that the tax should and could be extended to all types of property, that is: (1) real estate — land and buildings; (2) tangible personal property — machinery, business inventory (goods on the shelves and in process), cattle, household goods, furniture, jewelry; and (3) intangible personal property — shares of stock, bonds, mortgage notes, and bank accounts. Although the laws did call for such broad coverage, the tax rarely in fact applied with anything like the generality which the law presumably required.

Much property was never listed (recorded) on the tax roll. And in practice, though usually contrary to law, some types of property were valued for tax purposes on a very different basis from others — securities, furniture, and jewelry at a much smaller fraction of actual value than real estate. Today, as a rule, the tax falls on (1) land and buildings (except when exempt because owned by an organization qualifying for special treatment) plus (2) the machinery, equipment, and inventory of businesses plus (3) autos. When local governments tax household goods, they do so incompletely and on the basis of values which seem ridiculously low. In a few states owners are taxed on stocks, bonds, and some other intangible property; the rates actually applied are generally much less in relation to value than in the case of real estate.

Although the $23 billion (1965) property tax yield burden usually falls on the owners or the users of property, the tax...
relates to the property without regard for income, wealth, age, occupation, profit, sales, or other characteristics of the owners, whether individuals or companies. But not all owners pay. Exceptions arise in such cases as (1) property owned by religious and certain other non-profit organizations for their religious or designated purposes (but not ordinarily the property they hold to yield investment income); (2) governmentally owned property; (3) sometimes part of the value of a residence owned by an elderly person, a veteran, and even other owner-occupants; (4) occasionally property used by business firms newly established in the area.

Computation of Tax Rate. Overlapping governments — county, town, school districts — will each determine its tax rate for the year. A town, for example, will determine the dollar amount of property (the assessment) which will be subject to its tax. It then estimates the amount of revenue it must have from this source. If the total assessment is $20 million, and if the revenue needed is $120,000, a rate of 0.6% will yield the necessary amount. Then if from the same area the school district needs $200,000 and the county $40,000, the total rate for these three governments will be 1.8% applied to the assessed valuation.

City councils, school boards, and other bodies can make small changes in the tax rate, even as little as one mill per dollar of value (one tenth of one percent), to meet revenue needs. Such rate adjustments permit gradual changes from year to year. Politically, it is easier to make rate changes this way than to legislate new income or sales tax rates.

Administration. The property tax is administered on the basis of judgments of value which are often more or less arbitrary. The tax does not result from a market transaction as do income and sales taxes. A sales tax, for example, is based upon events which take place for reasons other than tax; buyers and sellers act on the basis of the benefit they hope
In many states the law appears to require that tax valuation be the amount for which the property would sell under normal market conditions on a specified date. The general practice, however, is to assess at much lower figures. For example, a nation-wide survey comparing actual selling prices of specific properties with the 1961 tax valuations found the assessments to be more often under, than over, 30 percent of prices at which the identical properties had sold. This survey also showed, as had so many of smaller scope, very wide inequality in under-assessment. In the same locality some properties might be underassessed by 40%, others by 80%, of market value.

For generations much administration of the property tax has been very poor. One result has been gross inequality in the treatment of taxpayers. Some have paid much more tax in relation to property holdings than have others. Bad administration has stemmed primarily from poor assessment. (1) Some property which should be taxed does not appear on the tax list. (2) Assessments in relation to actual value in the same locality are highly unequal; for example, in relation to current market value a few properties may be assessed at 5%, more at 10%, some at 50%, a few at 80% or more.

Good valuation of thousands of properties on a community's tax rolls requires much work and skill. Few American localities, however, have made the effort required to get the qualified manpower and other facilities needed to do the assessment job well. Deplorable conditions continue even though study after study has revealed that assessments are grossly unfair and has pointed out methods for improvement.

Each parcel of real estate — land and buildings — is, or is supposed to be, valued (assessed) once every few years.

8. Some states now make it legal to assess at half, or some such fraction, of market price.
affected by the property tax. Since the owner cannot alter supply, how then might he shift the tax? Ordinarily, there is no way. He bears the burden. The value of the land is not, ordinarily, the result of creative activities of the owner. Broad economic forces determine the worth of land in its pure sense as a gift of nature. As a locality grows, land values frequently rise. The property tax in effect “recaptures” for local government treasuries some of the land value which results from community growth.

Economic Considerations

One forceful criticism applies to the heavy taxation of buildings in many cities, taxes which are very high in relation to annual income from the structure. The tax discourages new building. As a result the quantity and quality of housing are below what they would be if this investment (and consumption) were taxed no more heavily than others.  

Most of the revenue, however, pays for services to the people who live in the houses and apartments which account for the tax. The fact that benefits go to those who pay most of the tax argues for use of this tax as a source of local revenue. This association of the property tax with the benefit from expenditure of the funds applies, of course, to the community as a whole and not necessarily to individuals. Some owners or users of property may bear appreciably more tax—and others less—than the value to them of local government services. Yet in at least one sense the overall result seems generally fair.

New construction and the postwar rise in real estate prices greatly increased the

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9. For a fuller analysis see Dick Netzer, Economics of the Property Tax. (Washington: The Brookings Institution, 1966), Ch. III.
property values on which the tax rests. Moreover, tax rates (per dollar of assessed value) have been raised time and again in most communities. Nevertheless, property tax revenue growth has lagged behind the increase in local government expenditure, for a combination of reasons. Owners of property have objected to rate increases. State laws sometimes set ceilings on the rates of property tax which localities may impose. Local officials have dragged their heels in raising assessments as much as the in real estate prices greatly increased the rise in real estate prices would justify. More and more property is exempt.

Other Local Revenues

A few states permit local governments to tax retail sales. Most California counties, for example, have a tax of one percent — and over 1,100 Illinois municipalities have a tax of 0.5 percent — added to the sales tax collected by the state. A few states allow local governments to impose "income" taxes, generally one percent or so of wages, salaries, and business incomes, with no personal exemptions or deductions; Detroit has a city income tax on all income over $600 per person. New York City's personal income tax, adopted in 1966, is imposed at rates ranging from 0.4 to 2 percent. One out of four cities with populations over 300,000 had an income tax in 1966 with annual yield around $500 million. Here and there one can also find local taxes on cigarettes, amusements, autos, gasoline, utility services, hotel rooms, and extraction of natural resources.

Local governments (and states as well) get revenue from charges and license fees. Some are essentially prices, requiring payment for a service or a product — a bus ride, water, or the fee for inspecting a restaurant, construction work in progress, or recording a document in an official record. But some "charges" have an element of taxation because they are compulsory (perhaps related to regulation which the "buyer" must accept) and quite unrelated to either the benefit or the cost of rendering the service. Charges may serve a useful purpose by restricting the quantity of service demanded and thus limiting the pressure on government to spend. Fines are penalties primarily imposed to deter law violation, but they also yield revenue. Unfortunately, some fees, license charges, and fines are a source of private income for a local official who is permitted to keep part or all of the money collected instead of turning it over to the public treasury.

Special assessments, yielding around $500 million a year, are generally imposed to pay for new streets, sewers, and other such facilities. At least some of the benefit from these capital improvements will accrue to the owners of the property in the immediate area rather than to the community in general. It seems logical, therefore, that the owners in the neighborhood rather than the entire locality be required to pay the cost. Special assessments are designed to do so, ordinarily over a period of several years. Yet difficulties of deciding how much of the cost of a project to allocate to each property can be substantial.
VI.

Evaluation of State-Local Taxes

Any evaluation of state-local tax systems will be debatable. In relation to the criteria set out earlier, however, the following observations seem to apply generally, but not necessarily to any particular state or locality.

Revenue Adequacy

To say that no state or local governments will ever have “enough” revenue would not be entirely correct. But the statement has an element of truth. Will there not always be desirable things on which to spend more money than is available? Services and transfers which someone wants state and local governments to initiate will not have been undertaken. How valuable might these neglected areas be? This question will challenge the best of minds. Similarly, we may disagree about the worth of some state-local spending already being done, with some of us perhaps concluding that revenue is more than adequate for the things which are really worth doing. In evaluating the adequacy of a state-local revenue system, therefore, conclusions rest on subjective judgments as well as on objective evidence.

Some facts, however, are clear. State-local revenue systems are yielding more (per capita and as a fraction of national income) than only a few years ago. Today’s yields are financing a substantial volume of services. Yet these revenues do not pay for everything being provided by state-local governments. Borrowing and Federal grants are also significant.

What about the future? As shown later, Federal grants will grow; borrowing can probably maintain about its relative role of recent years. State taxes now on the books will produce more and more; without appearance of strain, they will finance some rise in services per capita. Consumption tax revenues go up at about the same rate as national income, while income tax yields will rise somewhat more than proportionately.

More uncertainty exists at the local level—the property tax. “Automatic” yield increases due to new construction will vary from place to place. As regards tax rates and assessments, localities have some freedom and power of decision. In most cases they will be able, if they wish, to boost yields at a rate at least equal to, or perhaps greater than, that of the growth of income in the area. The wisdom of doing so will be debated, and many communities will not find property tax revenue increases adequate to meet the strong demand for growth of spending.

Distribution of State-Local Tax Burden

Table 12 presents estimates of how the state-local tax bill for the country as a whole was distributed among people at different income levels in 1965. Because tax structures, personal income,

1. For a full discussion, see Tax Foundation, Fiscal Outlook for State and Local Governments to 1975, currently in process.
2. Table 12 differs from Table 13, which applies to only part of state-local spending and covers a different year.
...and other factors vary greatly from place to place, the actual burdens in a particular place will be distributed differently from the averages here. For example, the personal income tax shown as an average for the country would not represent reality for, say, New York and New Jersey or Wisconsin and Illinois. These pairs of neighboring states include two, New York and Wisconsin, with income taxes much more progressive than the national average and two states with no general personal income tax.

Property tax is much the heaviest, with sales taxes next. In relation to income, total 1965 state-local taxes including social insurance taxes ranged from 12.7% to 9.6% of income for families having $2,000 to $9,999 — approximately 80% of the total population. As a percentage of income, total burdens are above average at the lowest level and below average for incomes over $6,000. The over $10,000 income groups, of course, pay much more of the total tax, 21% compared with the 9% paid by families with income under $3,000. The 1.1 million families with after-tax incomes of $15,000 or more paid nearly as much state-local tax as the 14 million with incomes under $3,000. The distribution of burden differs markedly from that of Federal taxes; in relation to income, Federal burdens are much higher at the top of the income scale and smaller at the bottom.

How does the distribution of taxes compare with the benefits from state-local spending? Tremendous difficulty arises in attempting to measure the value of the benefits of state-local spending received by (i.e., "distributed" among) different groups of the public. Table 13 presents results from one study. They cover about two-thirds of total state-local spending (from their own revenue sources) in 1961. They assume, among other things, that the benefits

### Table 12

**Distribution of State-Local Tax Burden by Income Class and State-Local Tax Burden as Percent of Income**

<table>
<thead>
<tr>
<th>Income Class (Money Income after personal taxes)</th>
<th>Taxes ($) (billions)</th>
<th>As percent of total taxes</th>
<th>As percent of total income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $2,000</td>
<td>$ 2.7</td>
<td>4.0%</td>
<td>15.1%</td>
</tr>
<tr>
<td>$ 2,000 to $ 2,999</td>
<td>3.6</td>
<td>5.4</td>
<td>12.7</td>
</tr>
<tr>
<td>3,000 to 3,999</td>
<td>5.2</td>
<td>7.7</td>
<td>12.6</td>
</tr>
<tr>
<td>4,000 to 4,999</td>
<td>7.1</td>
<td>10.6</td>
<td>11.8</td>
</tr>
<tr>
<td>5,000 to 5,999</td>
<td>8.6</td>
<td>12.8</td>
<td>11.5</td>
</tr>
<tr>
<td>6,000 to 7,499</td>
<td>12.2</td>
<td>18.2</td>
<td>10.8</td>
</tr>
<tr>
<td>7,500 to 9,999</td>
<td>13.4</td>
<td>19.9</td>
<td>10.1</td>
</tr>
<tr>
<td>10,000 to 14,999</td>
<td>9.2</td>
<td>13.7</td>
<td>9.6</td>
</tr>
<tr>
<td>15,000 and over</td>
<td>5.2</td>
<td>7.7</td>
<td>9.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$67.2</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>10.8%</strong></td>
</tr>
</tbody>
</table>

*Based on assumption that half of the corporate income tax is shifted to consumers while half falls on stockholders.

Table 13
Benefits of State-Local Spending by Income Class, 1961
(Dollar amounts in millions)

<table>
<thead>
<tr>
<th>Income class(a)</th>
<th>Income(b)</th>
<th>Allocated benefits of state-local expenditures (excluding general benefits(c))</th>
<th>Benefits as percent of income</th>
<th>Cumulative percent of expenditure benefits to upper limit of class</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $2,000</td>
<td>$13,742</td>
<td>$3,159</td>
<td>23.0%</td>
<td>9.4%</td>
</tr>
<tr>
<td>$2,000 to $2,999</td>
<td>21,489</td>
<td>3,225</td>
<td>15.0%</td>
<td>19.0%</td>
</tr>
<tr>
<td>3,000 to 3,999</td>
<td>31,678</td>
<td>3,336</td>
<td>10.5%</td>
<td>29.0%</td>
</tr>
<tr>
<td>4,000 to 4,999</td>
<td>46,131</td>
<td>3,910</td>
<td>8.5%</td>
<td>40.7%</td>
</tr>
<tr>
<td>5,000 to 5,999</td>
<td>57,499</td>
<td>4,349</td>
<td>7.6%</td>
<td>53.7%</td>
</tr>
<tr>
<td>6,000 to 7,499</td>
<td>86,474</td>
<td>5,583</td>
<td>6.5%</td>
<td>70.4%</td>
</tr>
<tr>
<td>7,500 to 9,999</td>
<td>100,912</td>
<td>5,276</td>
<td>5.2%</td>
<td>86.2%</td>
</tr>
<tr>
<td>10,000 to 14,999</td>
<td>73,716</td>
<td>3,348</td>
<td>4.5%</td>
<td>96.2%</td>
</tr>
<tr>
<td>15,000 and over</td>
<td>43,227</td>
<td>1,254</td>
<td>2.9%</td>
<td>100.0%</td>
</tr>
<tr>
<td>Total</td>
<td>$474,868</td>
<td>$33,440</td>
<td>7.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

a. Income class limits are expressed in money income after personal taxes.
b. Broad definition of Income, equivalent in the aggregate to net national product.
c. Not included are welfare, highway, and other expenditures paid for by Federal grants. Also excluded are $17.7 billion of "general benefit" expenditures, those for general administration and personnel, police and fire protection, prisons, urban renewal, conservation, health and sanitation, and a few miscellaneous functions, included are outlays from state-local sources for education, public assistance, labor and manpower, veterans services, highways, agriculture, net interest, and unemployment insurance.


from these state-local government expenditures are worth (in dollar terms) the amount spent on them. The estimates are for the country as a whole. In relation to income, benefits were very large for the poor and small for families with incomes above $15,000.

Such figures must be used with caution. In estimating how much of the total goes to the lowest income groups, to those with somewhat more income, etc., many perplexing questions appear. As a result, the best of answers must be unsatisfactory. For example, the benefits of most governmental services are partly, and some are largely, general rather than individual. The proportions of general as against individual benefit are by no means clear. Does all of the benefit from $1,000 of welfare aid to a poor family rest with it, or does some — and if so, how much — of the benefit spread to everyone, presumably by making for a generally better society? Or assume that we could agree that X percent of total spending on schools benefits the families with children in school. We might still be unable to decide whether the amounts per child are the same. Does benefit from streets vary with the amount of direct use? How can we allow for the fact that patterns of the distribution of benefit will differ from one community to another?

Such questions suggest some of the reasons why estimates allocating total benefits of state-local spending must be used with restraint. Nevertheless, carefully made calculations are better than mere guesswork. The person who believes that the underlying assumptions