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THE COORDINATION AND INTEGRATION OF FEDERAL, STATE, AND LOCAL TAX SYSTEMS

JAMES K. HALL*

Of the fiscal problems pressing for immediate solution, few are as important economically and socially as the problem of establishing proper working relationships between and among the fiscal systems of the federal, state, and local governments. Today, as in the past, there is a conspicuous lack of coordination and integration among these several revenue systems. Only in recent years has any considerable emphasis been placed on the importance and necessity of visualizing our fiscal problems in perspective—of viewing the problems and issues of local, of state, or of federal finance as integral parts of a related whole. Pragmatic exigencies often have required, apparently, separate and isolated treatment of fiscal problems of some one, or several, political jurisdictions of the same class, as distinct from the other jurisdictions with which there is interrelation of problems. The results demonstrate the basic superficiality and futility of this approach. Until recently, discussions of the financial relationships of our several governments have been largely confined to academic halls and treatises and to some few professional and technical associations. In the last two decades the subject of the relationship of the tax systems of the local governments, the commonwealths, and the nation has attracted an increasing amount of interest from the public, our political leadership, and our academicians. The existing situation is receiving an increasing measure of censure and condemnation. In some cases, considered proposals looking toward reform have been made.

The problem of fiscal coordination and integration is but a part of the larger problem of intergovernmental relationships in their

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many phases. So closely interlocked with the problem of fiscal integration are the problems of revision and improvement in our governmental structure and the coordination of governmental functions that, for purposes of perspective, they should not be disassociated. The establishment of healthy fiscal environments for our political jurisdictions must be accompanied by the elimination of overlapping and duplicating administrative units and the coordination and proper placement of governmental functions. We should recognize that governmental revenues are simply the counterpart of governmental expenditures, which, in turn, depend upon the character and extent of governmental functions and of the administrative structure which has been erected for their performance.

By tradition and custom the geographical area over which a government has jurisdiction has determined its relative prestige and importance. As stated by Professor Leland, "acres of occupancy rather than the importance of functions performed or the volume of operations" has been the criterion of governmental ranking. Under loosely knit federalism, our jurisdictional structure has developed with the public following dictates of individualism, experimenting not wisely but well, believing in the efficacy of home rule, and opposing centralization and standardization. There has evolved, in consequence, a multiplicity of governments and administrative agencies with such variation, duplication, and overlapping of structure and of function as best to be described as a chaos of areas, a chaos of authorities, and a chaos of revenues. Logically, a complex economic and social order should require a complex governmental organization. However, to plumb the depths of absurdity with the gross and unnecessary development of layer upon layer of administrative units, with functional duplication of the most illogical and wasteful character, and with an extreme lack of structural and functional coordination is not to accommodate government to the facts of a complex economic and social organism. Rather, conflicts, frictions, and economic wastes are promoted—to the public disadvantage. Existing governmental complexity provides no enviable claim to distinction.

In Cook County, outside the limits of Chicago, are found "9 cities, 76 villages, 30 townships, 192 school districts, over 30 park


districts, over 40 road and bridge districts, 2 sanitary districts, and enough additional subdivisions of government to aggregate 415 separate, independent units, each having power to levy taxes and borrow money. In Chicago are found corresponding confusion and duplication in structure and functions with, for example, "twenty different authorities dealing with parks and recreation" and "five separate civil service commissions engaged in the task of hiring public employees. The State of Washington with 2,505 political jurisdictions having power to levy property taxes and to incur debt, among which are found 1,714 school districts, is, perhaps, rather typically illustrative of this situation in the West.

Our political jurisdictions in point of geographical area and population have a wide range. The largest county in area in the United States is San Bernardino County, California, with 20,175 square miles. The combined area of the States of New Jersey, Delaware, and Maryland is smaller than this one county. The county government recognized as the smallest is that of Arlington County, Virginia, which has an area of 25 square miles. In population, Cook County, Illinois, is the largest with 3,982,123 inhabitants, and Alpine County, California, the smallest with 241 inhabitants. Curiously enough, the range in area from the largest to the smallest county is about the same ratio as the range in population, approximately 20,000 to 1. It is also interesting to note that there is a significant inverse relationship between population and area. The Bureau of the Census, as of July 1, 1934, reported a total of 167,699 units of government with power to levy direct property taxes. The thousands of governmental units which do not levy property taxes are not included in this aggregate. The three classes of jurisdictions with the largest number of units are school districts, 123,627, townships, 19,980, and cities.

5 Ibid., p. 100.
6 Ibid., p. 101.
7 United States Bureau of the Census, Number and Interrelationship of Governmental Units That Levy Property Taxes, as of July 1, 1934, p. 6 (mimeographed report).
8 Anderson, Wm., The Units of Government in the United States, 1934, p. 15.
9 Anderson, Wm., op. cit., p. 15.
10 Ibid., p. 17.
11 Ibid.
12 Ibid.
13 Ibid.
14 Number and Interrelationship of Governmental Units That Levy Property Taxes, as of July 1, 1934, p. 2 (mimeographed report).
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towns, and villages, 16,389. A rationalized plan of local governmental structure, as outlined by Professor Anderson, would reduce the number of jurisdictions to approximately one-tenth the present number. As Professor Lutz suggests, it is indeed fortunate that the home rule issue has not arisen in support of the "ward or the block as the smallest unit within which the people were presumed to possess and enjoy the privileges of home rule." With horizontal and vertical duplication and overlapping in governmental structure and functions, the questions of fiscal support, inequitable taxation, and efficient performance of governmental responsibilities become exceedingly troublesome. With the continued expansion of the intensive and extensive functions and services of government, these questions will become even more serious. Recognition of the unequal distribution of wealth and income among individuals, economic groups, geographical areas, and existing political jurisdictions must be had, also, recognition of the mobility of persons, wealth, and income, and an understanding that industry and commerce have no regard for state and local governmental boundaries. Our governmental structure and authority must be rationalized with the conditions and facts of modern economic life if material progress is to be made in reorganization and integration of our fiscal systems. It is hoped that the triteness of these remarks will not detract from their underlying importance.

If we view briefly the existing fiscal relationships of our federal, state, and local tax systems, there is disclosed a situation of partial separation of sources of revenue,—meaning thereby merely types or forms of taxes and not the ultimate sources of purchasing power,—of dual administration and use of the same types of taxes, and a system of subventions and aids from the federal to the state governments and from the state to the local governments. The fiscal interrelationships, such as there are, are haphazard, ill-conceived, temporary compromises to serve the need of the moment.

The Federal Government, although a government of delegated powers from the Constitution, has broad authority to tax in its support. The American public and the framers of the Constitution gained a valuable lesson in public finance under the Articles of Confederation when the Federal Government was hard put to survive fiscally, and hence politically. There was a realization

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15 Ibid.
that no government of a sovereign character can maintain its dignity and discharge its political responsibilities when its fiscal existence is predicated on the questionable generosity and irregular subsidies of other sovereign governments. The liberal provisions of the Constitution relating to the taxing powers of the Congress are testamentary of a well-earned lesson.

The power of the Federal Government to levy taxes drawn from the Constitution likewise is limited by that document. The Congress can levy taxes provided that the object or person subject to the tax is not outside its jurisdiction (sovereignty rule), provided, apparently, that the power of taxation is exercised for a public purpose as distinguished from a private purpose (welfare rule), provided that direct taxes, e.g., property taxes, with the exception of income taxes, are apportioned among the several states on the basis of population (apportionment rule), provided that indirect taxes are levied in accordance with geographical uniformity (uniformity rule), provided that no duties or taxes are levied on exports from the states, provided that the taxing power is not used in a capricious or palpably unreasonable way so as to be a violation of due process, provided that the taxing power is not used for regulatory or other ulterior purposes in interference with the powers reserved to the states, and provided that the taxing power is not applied to the instrumentalities or means employed by the states in discharging their general, as distinguished from their proprietary, governmental functions. Subject to these limitations which define the scope of the federal taxing power, the Congress may act to fortify financially the Federal Treasury. The states have been generous, perhaps even more generous than was realized at the time. However, with the growing belief that government is one, that functions are more important than political jurisdictions, that serious fiscal frictions must be eliminated, and that the cost of government as a whole must be minimized to an extent consistent with the efficient performance of necessary services, it is not unreasonable to venture the prediction that the states would agree to the elimination of the apportionment rule and to

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19 Ibid., Amendment XVI.
20 Ibid., Article I, Section 9, Clause 4.
21 Ibid., Article I, Section 8, Clause 1.
22 Ibid., Amendment V.
23 Ibid., Amendment X.
24 This limitation arises by reason of the existence of dual sovereignties in our government. See Indian Motorcycle Co. v. U. S., 283 U. S. 570.
a program of closely knit fiscal relationships with the Federal Government.

The state taxing power lies in its inherent right of sovereignty. The states, as in the case of the Federal Government, are subject to the sovereignty rule and to the limitation of levying taxes for public purposes only. The states are further limited in their use of the taxing power by provisions of the Federal Constitution which seek to maintain the theory of dual sovereignty. They may not enact tax or other statutes which conflict with the Federal Constitution, laws, or terms of treaties with foreign nations. There must not be interference with the borrowing power of the Federal Government or the obligations of contract in the exercise of the taxing power. In addition, the states may not levy duties on tonnage, discriminate against citizens of other states, levy duties on imports or exports without the consent of the Congress, be so arbitrary and unreasonable in taxation as to violate due process, deny to a person the equal protection of their laws, interfere with interstate or foreign commerce, or tax Federal functions or instrumentalities. The respective state constitutions also limit the character and extent of tax legislation. Requirements that taxes must be equal and/or uniform are commonly found. Except for these limitations and such others as may be embodied in their constitutions, the states are free to tax as they see fit.

Local governments, the creations of the states, as counties, townships, municipalities, and special taxing districts, have no inherent powers to tax, instead, they may tax only in accordance with the delegated powers which may be withdrawn or amended whenever the states so desire. In general, however, the states have granted to local governments rather broad taxing powers. While this may be consistent with the home rule principle, multiple taxation and fiscal confusion have been the result of the tax activity of these numerous quasi-independent local political entities.

The customary or traditional fiscal relationship between the Fed-

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27 United States Constitution, Article VI, Clause 2.
28 Ibid., Article I, Section 8, Clause 2.
29 Ibid., Article I, Section 10, Clause 1.
30 Ibid., Article I, Section 10, Clause 3.
31 Ibid., Article IV Section 2, Clause 1.
32 Ibid., Article I, Section 10, Clause 2.
33 Ibid., Amendment XVI, Section 1.
34 Ibid.
35 Ibid., Article I, Section 8, Clause 3.
36 An implied limitation based on dual sovereignty. See Macallen Co. v. Commonwealth of Massachusetts, 279 U. S. 620; Panhandle Oil Co. v. Mississippi, 277 U. S. 618.
eral Government and the states until the Twentieth Century was separation of sources of revenue except in times of financial emergency when the Federal Government, temporarily, entered the field of direct taxation. Otherwise, the latter government held persistently to the use of indirect taxes in the form of customs duties, and from time to time internal excises. The first direct taxation by the Congress was in 1798 by the placement of a property tax on "dwelling-houses, lands and slaves." A similar tax was enacted in 1813 upon "lands, lots of ground with their improvements, dwelling houses and slaves," and a like tax in 1815. The Federal Government, faced with a fiscal emergency at the outbreak of the Civil War, again laid a tax on real estate. In these and other instances the rule of apportionment was followed. The Federal Government made but two attempts, on emergency occasions, to utilize income taxes prior to 1909. The first attempt was in 1861 and continued until 1872, during which period it was regarded as an indirect tax, the second was in 1894. The latter Act did not become operative. The program of federal taxation, therefore, has been one of reliance primarily on customs and excises for revenue.

The state and local governments, on the other hand, relied principally upon the property tax with limited use of excises, license taxes, fees, and other small miscellaneous sources of revenue. It was not until the latter part of the Nineteenth Century that inheritance taxes became an established feature of many of our state tax systems. While there had been some experimentation with income taxes, it was not until the successful demonstration of Wisconsin in 1911 that income taxes came into widespread use as desirable state fiscal instrumentalities. The extent to which separation of sources of revenue had been followed by the state and federal governments is revealed by the almost complete absence of duplicating types of taxes at the time the first National Conference on State and Local Taxation was held in 1907. Since then the rapid adoption of income, inheritance and estate, and internal excise taxes by the commonwealth and national governments has led to extreme duplication in types of taxes. Were duties on imports not reserved by the Constitution to the exclusive use of the Federal Government, the states doubtless would have tried to

37 1 U. S. Statutes 597-8. (A levy of $2,000,000.)
38 3 U. S. Statutes 53, 26. (A levy of $3,000,000.)
39 Ibid., 164. (A levy of $6,000,000.)
40 12 U. S. Statutes 294. (A levy of $20,000,000.)
41 Professor Haig states that the Federal Government resorted to direct taxes on property on no less than five occasions during the period 1798 to 1861 inclusive. Haig, R. M., op. cit., p. 222.
42 Haig, R. M., op. cit., p. 222.
utilize that source of revenue in their frantic efforts to augment income.

Personal income, as of January 1, 1934, is taxed by twenty-six states and the Federal Government. Under fiscal pressure, Alabama, Arizona, Kansas, Minnesota, Montana, and New Mexico adopted and applied the personal income tax in 1933 for the first time. The wide diversity and inequality in state income taxation may be realized when residents are taxed on incomes from all sources in twenty-one commonwealths, the exceptions being the States of Massachusetts, Minnesota, New Hampshire, Oregon, and South Carolina, while non-residents are taxed on income derived from sources within the state by twenty jurisdictions, the exceptions in this instance being Delaware, Massachusetts, New Hampshire, Tennessee, Utah, and Vermont. Exemptions vary from none in Ohio and Tennessee to $2,000 per single person in Massachusetts. Twenty-two states express the exemption in dollars of net income, while two states, Arizona and Wisconsin, provide an exemption in dollars of computed tax. Twenty-one states have progressive rates with a range of maximums from three to fifteen per cent. New Hampshire, Ohio, Tennessee, Massachusetts, and Vermont tax under proportional rates, although the latter two vary the flat rates with the character of the income. Offset legislation has appeared in conformity to the demand of property owners that taxes on realty be reduced. Fortunately, however, only two states apply such ill-advised provisions, namely, Utah and New Mexico. Six states, to avoid, partially, a type of double taxation, permit non-residents a credit allowance on income taxes paid to other states which grant a reciprocal privilege. Virginia, New Mexico, North Carolina, Georgia, Kansas, and Vermont provide similar credits to residents.

The Federal Government and twenty-six states, including Ohio, as of January 1, 1934, lay taxes on, or measure taxes by, corporate net income. The Ohio statute, according to the law and to judicial interpretation, is construed as a property tax and not as an income tax. As interest paid may not be deducted from interest received under the Ohio statute, it is, economically, a corporate income tax measured by modified gross income. Fiscal necessity in the last few years has caused a number of states to adopt corporate net income taxes as, e.g., Arizona, Kansas, New Mexico, North Carolina, and Oklahoma. Twenty states utilize proportionate rates with the

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*These and following data relating to tax systems have been taken from Tax Systems of the World, fifth edition, 1934, The Tax Research Foundation.

*The property offset provision in the New Mexico personal income tax was repealed by the special session of the legislature April 27, 1934. New Mexico, Laws Extra Session, 1934, Chapt. 29, sec. 4, p. 117.*
maximums ranging from two per cent to eight per cent, while six states provide for progressive rates with the maximums ranging from four per cent for Idaho to six per cent for Mississippi, Oklahoma, and Wisconsin. One aspect of unequal taxation of corporate net income, although, perhaps, not of serious practical import as now applied, continues to find expression in the provision of progressive rates. Haphazard and wide variation in the exemption of classes of corporations is the rule rather than the exception. Uniformity, likewise, is conspicuously absent in the determination of non-taxable income and the allowed deductions. Provision is made for the exemption of a portion of the corporations' net income by the States of Alabama, Arkansas, Minnesota, Mississippi, New Mexico, and Massachusetts. The allocation factors or formulae used for purposes of apportioning net income for corporations doing an interstate business are unstandardized and vary in the case of almost every state. The simplest, and perhaps the most inequitable formulae, are applied by Arkansas and Tennessee in which apportionment of net income is on the basis of the gross sales within the state to total gross sales. The majority of the states taxing corporate net income have tried in recent years to develop more refined formulae but without achieving any standardization of practice. The problems of double taxation caused by the use of inconsistent and conflicting methods of income allocation are very serious and will become increasingly troublesome as the number of states taxing corporate income increases, unless there is standardization of formulae. The highly peculiar and inequitable results now obtaining leave little room for doubt.

The Committee on Uniformity and Reciprocity in State Taxing Legislation of the National Tax Association secured information relating to the taxation of four large interstate corporations as a basis for its study and report in 1930. The situation found was of a character to present a major challenge to our existing tax policies and practices. A summary of these data as stated by the Committee is as follows:

"'A' corporation is engaged in business in thirty-five states. It pays a total of 198 taxes, or an average of six per state, in thirty-three different forms, running from one tax to thirteen taxes per state.

"'B' corporation is engaged in business in twenty-seven states and is obliged to prepare and file sixty different reports, each with peculiar characteristics, the number being required by the various states running from one report to five per year.

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*Report of Committee on Uniformity and Reciprocity in State Taxing Legislation, Proceedings, National Tax Association, 1933, p. 262.*
"'C' corporation is engaged in business in thirty-six jurisdictions and finds itself subject to 108 taxes of eighteen varieties, the least popular being imposed by one state, and the most popular by twenty-four states.

"'D' corporation, which is a manufacturing corporation, has twelve plants in the United States and Canada, and finds that its 1928 taxes varied from 0.47 to 2.84 at each plant in the ratio of the amount of taxes to the book value of taxable property and from 0.45 to 2.13 in the ratio of total taxes to the output of each plant."

In the above illustrations the computations relate only to taxes and charges of the states and property taxes imposed by the local governments and not to the large variety of licenses, fees, and charges which local governments commonly see fit to exact. The language of the Committee is apt in describing such gunshot tax inflictions of our state and local governments as "comparable in number and bitterness to the plagues sent upon Egypt."

The lack of cooperation between and among the states and the rivalry which is engendered by competitive bidding for capital, business, population, and private wealth result in gross incongruities and vicious practices exemplified both in tax laws and tax administration with especial reference to the property tax. It is not confined to the states, as the localities likewise seem to find it to their advantage to participate in the "good" work. With much capital highly mobile, with the tax situs of persons of wealth and large incomes subject to relatively easy change, with many business corporations able and willing to shift or change their operations in response to state and local tax policies, those states attempting to practice reasonably uniform and equitable taxation find themselves at a distinct disadvantage. Premiums are placed on unfairly discriminatory tax laws and tax administration. Harold M. Groves, of the Wisconsin Tax Commission, has called attention to the major difficulties of maintaining scientific assessment and equalization of property taxes in a state such as Wisconsin when neighboring states are engaged in the effective prostitution of their tax systems to serve competitive purposes. Commissioner Groves states that one large corporation in Wisconsin pays taxes 350% higher than would be required in an alternative location in Michigan. In 1927, one moderately important manu-

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48 Ibid.
facturing corporation in Wisconsin had its inventory assessed for taxation in an amount almost equal to the assessment of all the manufacturers' inventories in Illinois, or $13,000,000 to $15,140,000 in the former as compared with the latter.\textsuperscript{51} It is significant also that the assessment of manufacturers' tools, machinery, and equipment in Illinois declined fifteen per cent from 1921 to 1927.\textsuperscript{52} In the State of Washington the aggregate unequalized assessed valuation of property was $1,006,310,548 in 1933 as compared with $962,602,783 in 1911.\textsuperscript{53} The evils of underassessment, of inequitable assessment, and of partial or complete tax exemption of property which should be on the tax rolls (through the use of legal and extra-legal procedures) are so well known as not to require elaboration.\textsuperscript{54}

Inheritance and/or estate taxes, as of January 1, 1934, are in effect in every state of the Union. State inheritance taxation is characterized by the same absence of uniformity, both in form and in practice, as in the case of income taxation. However, the provision of the Federal Estate tax which establishes a credit of eighty per cent of the amount of death duties paid to the state against the federal tax—described by Professor Lutz as a "means of whipping the Devil around the bush"\textsuperscript{55}—has been influential not only in causing the states to adjust the weight of their death taxes to take full advantage of this credit, but to enact this form of tax legislation. Thirty-five of the states provide for state absorption of the full eighty per cent credit.

Multiple taxation of intangibles, and to a lesser extent of tangible personalty, has been an undesirable and inequitable feature of state inheritance taxation in the past. Under the leadership of the National Tax Association the states have been encouraged to enact reciprocity legislation in regard to the non-taxation of intangible personalty of non-resident decedents. Legislation of this character has been passed by thirty-nine states. Recent decisions of the United States Supreme Court appear to have clarified the situation and to have made impossible the double taxation of the same assets even by the non-reciprocal states.\textsuperscript{56} In Frick v. Pennsylvania,\textsuperscript{57} the rule was clearly established that the state of domicile of the decedent owner of tangible personalty could not tax

\textsuperscript{52} \textit{Ibid.}
\textsuperscript{53} Data from the Washington State Tax Commission.
\textsuperscript{54} See Simpson, H. D., Tax Racket and Tax Reform in Chicago, 1930, for a discussion of the situation in Chicago and Cook County, Illinois.
\textsuperscript{55} Lutz, H. L., Public Finance, 1930, p. 543.
\textsuperscript{56} Report of Committee on Uniformity and Reciprocity in State Tax Legislation, op. cit., 1932, p. 183.
\textsuperscript{57} 268 U. S. 473 (1925).
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Tangible personalty having an "actual" situs elsewhere. In the state inheritance taxation of intangibles, the Supreme Court, in applying the maxim *mobilia sequuntur personam*, subject to the exception that intangible personalty may acquire a business situs apart from the owner, holds that this kind of personal property cannot be within the taxing power of more than one jurisdiction.53

While the majority of states have provisions relating to the taxation of gifts made in anticipation of death, a number do not. Rates of inheritance taxation vary widely, as do exemptions for beneficiaries, classification of beneficiaries, and the degree of progression as determined by the rates and the character of the blocking.

Although multiple taxation of the assets of a decedent's estate by the states appears to be a thing of the past, there is no standardization of taxing practice among the states, as is evidenced by the variation in rates, classifications, and exemptions. Furthermore, the federal and state governments combine in the use of the same form of taxation, thereby causing delay, friction, and ill-feeling.

Existing excise taxation by the federal, state, and local governments presents a situation of confusion confounded. Few illustrations are needed to show the low level of tax competition to which our political jurisdictions have descended in their intensified search for revenue. Gasoline taxation, while originally a state revenue device, is now used by municipalities and counties, by all the states, and by the Federal Government. First adopted by the State of Oregon in 1919 and taxed typically at a rate of one cent a gallon, gasoline is now taxed by the states at rates ranging from two to seven cents per gallon. In 1932 the gasoline tax produced revenue in excess of a half billion dollars for the states. Tobacco is specially taxed by the Federal Government and fifteen states with wide variation in rates and taxing procedure. State excise taxation of this commodity is a product of the last decade. Eight states have registration taxes on mortgages and/or bonds, stocks, leases, and the like, in conjunction with the Federal Government which also imposes a tax on conveyances. The state rates range from two cents in Oklahoma to fifty cents in New York per hundred dollars of value. The rates in Oklahoma are graduated in conformity with the length of time of maturity of mortgages. Electrical energy, taxed by the national government at three per cent, is taxed also

by the States of Alabama, Idaho, South Carolina, and Vermont at two-fifths mill per k.w.h. in Alabama and one-half mill in the other states. Electricity produced by municipal plants is exempted from excise taxation by South Carolina, Vermont, and the Federal Government. General turnover taxes, retail sales taxes, and various hybrid forms of sales taxation are found in twenty-six states, according to the classification of the Tax Research Foundation. They vary in character from the limited coverage retail sales taxes of California and of Illinois to the multiple classified gross sales taxes of West Virginia and of Washington. Fiscal nomenclature is somewhat lacking for adequate descriptions of certain of these tax mutations denominated by statutes as gross income, merchants' and manufacturers' license, chain store, retail sales, and business and occupation taxes. Perhaps, as analogous to the Missouri mule, these fiscal by-products of the current economic depression are, similarly, without pride in ancestry and hope of posterity. Few forms of taxation have accomplished more in the way of producing industrial and commercial friction, unreasonable discrimination, and general dissatisfaction than these devices born of fiscal need and with a statutory configuration formed of legislative ignorance, bickerings, dickerings, and compromises.

Enough has been said concerning the existing status of the tax systems, if they can be called systems, of our federal, state, and local governments to indicate the seriousness of the fiscal disequilibrium, non-uniformity, inequity, uncertainty, and administrative difficulties which are involved therein. Sooner or later our essential governmental functions will be seriously affected if some measure of economy, of balance, and of rationality is not interjected into our tax systems. Although there has been little rational planning of the tax systems within the states, even less attention has been directed to the integration of state systems into the national pattern. The increasing complexity of state and local tax systems—a product of the increasing demand for more revenue and the growing complexity of our economic structure—has caused wider variations in taxing practices and greater dissimilarity in the burdens of taxpayers.

The remedial measures which are required to solve the problems of our uncoordinated tax systems follow the causes. Double taxation, diversity in forms of taxation, administrative difficulties, uneconomical tax administration, and the like, have their roots in tax decentralization and non-integration. The broad problem is one of articulating our fiscal and political systems with the facts of present-day economic life.

That which is needed is fiscal centralization and standardization
similar to that which now obtains in the economic field. A like change is required in our highly decentralized political system. The incompatibility of localizing wealth, income, and economic activity for purposes of taxation, when these tax bases are national and international in scope, should be obvious to all. There is little doubt that fiscal integration must be accompanied by a re-allocation of governmental functions and a properly synthesized political system.

In considering the rationalization of our fiscal systems there are certain principles which should not be overlooked. Dual administration of the same form of tax should not be countenanced. Apparently no good purpose is served by it. A prima facie case exists against duplicating tax administration. From the point of view of the taxpayer it is illogical and wasteful, involving as it does unnecessary administrative expense and additional trouble, uncertainty, and expense to the taxpayer. As we would not think of having a separate force of tax-gatherers for each jurisdiction levying a property tax, e.g., school district, city, township, county, and state, so should we avoid our duplicating sets of tax-collectors in income, inheritance, and excise tax administration. The administration of the several forms of taxation should be placed in the hands of those political jurisdictions which can achieve the highest measure of equality, economy, and general effectiveness. In illustration, the property tax, doubtless, should be administered by the states rather than the townships or counties, the income tax by the Federal Government exclusively, rather than state-administered income taxes, the inheritance tax likewise. In other words, the taxing authorities must be brought into conformity with, or made suitable to, the various tax bases.

The problems and tasks of tax administration should be divorced from the financial requirements of the several political jurisdictions. The problem of effective tax administration is one which should not be clouded or subverted by the problem of the appropriate division and/or provision of funds to our divisions of government. To the assumption that each of our units of government should be permitted independently to levy taxes to meet the costs of that government, regardless of how unsuited that jurisdiction may have been, or is, to administer taxes, is traceable much of the tax confusion and maladministration of today. If this perspective can be gained, fiscal integration should not be overly difficult. It is submitted, further, that until taxes are re-allocated or are assigned to those governments best suited to administer them, and until this problem is solved on its own merits, the establishment of an orderly and economical tax system, in all likelihood, will not be realized.
Of the many proposals which have been made for coordination and integration of our fiscal systems only "division of the yield" and/or the use of "supplements or additions" appear worthy of serious consideration. Separation of sources of revenue, meaning thereby merely separation of forms of taxation, does not imply coordination or integration in any real sense, rather, there is implied, first, independence in choice of taxes as long as duplication with other jurisdictions above or below in the political structure is avoided and the Constitution is not contravened, second, multiplication of forms of taxation as the need for revenue increases, third, a lack of balance between revenues and needs for some divisions of government, as it is almost inconceivable that each government will secure revenue sources proportionate to its needs, and, fourth, more or less violation and disregard of efficiency and economy in tax administration. The use of a system of credits, while it secures, perhaps, coordination of a kind, does not prevent multiplication of forms of taxation or obtain effectiveness and economy in tax administration as in the case of separation of sources of revenue. Further, tax crediting, as practiced by the Federal Government in the estate tax, has led to compulsion and rigidity in that the states have felt it incumbent upon them to adopt inheritance and/or estate taxes and, in addition, to adjust the rates of tax to take full advantage of the credit. An extension of the credit system would cause more, not less, duplication and complexity in taxation. If the Federal Government provided a credit against some or all of its internal excises, the states, in all probability, would quickly adopt similar taxes in amount and number to absorb the full credit allowance. There would be also the fiscal emasculation of federal revenues, to the extent that credits were allowed, in proportion to such allowance. The virtues of crediting lie in the encouragement of a limited amount of standardization of forms of taxes at the expense of greater duplication and in the reduction somewhat of tax competition and evasion.

Division of the yield, on the other hand, introduces a unitary system of administration. Under this proposal, the Federal Government would be assigned those taxes in which substantial administrative advantages are possessed in comparison with the states, and the states taxes in which like advantages are had in comparison with the local governments. Provision for the distribution or division of the yield of taxes among the units of government in correspondence with the relative scope and cost of functions would be required. The substance as well as the form of tax integration would thus be achieved. The thorough-going application of this plan, doubtless, would mean the withdrawal of the local govern-
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ments from the field of taxation, with the possible exception of certain local license taxes, the states would administer the property tax and corporation license taxes, while the Federal Government would be charged with the administration of death duties, and income, excise, and sales taxes. The principal advantages of the system of division of yield would be the attainment of simplicity of tax structure, efficiency, and economy in tax administration, and the elimination of tax competition, friction, and evasion by the rationalization of our tax authorities to our tax bases. There are serious obstacles to the realization of this type of fiscal relationship. Our state and local governments probably would not favor what appears to be the financial domination of the Federal Government, and would hesitate to be placed in a position of fiscal dependence. Division of yield is defective in that no provision is made for certain necessary elasticity in revenue. This would be particularly serious for the state governments. It is not improbable that under this system certain or all of the states may suffer a deficit in some years while the Federal Government may be faced with a surplus. The problem of effecting some satisfactory arrangement as to the division of the yield between the state and federal governments would be difficult of solution. It is hardly to be expected that there would be unanimity of opinion as to the criteria which should serve for division of the revenues. However, it is not believed that this is an insuperable obstacle to the adoption of division of yield, as Professor Haig and others are inclined to think, apparently. In fact, progress has been made in this direction by sharing state-administered taxes with the local units of government. In 1931 only the States of Delaware, Rhode Island, Utah, and West Virginia did not have state-administered locally-shared taxes. The taxes subject to division of yield are principally corporation, income, and motor fuel and motor vehicle taxes. The yield of these state-administered locally-shared taxes in 1928 was $261,217,000 of a total state tax revenue of $1,766,950,000, or a ratio of fourteen and seven-tenths per cent.

Under the pressure of reparation payments in the post-war period, the fiscal system of Germany was drastically changed in the direction of a unitary system. Division of yield has been the method followed to achieve integration. The national government is now the most important tax levying and collecting authority. There is division of yield to the states with a further sub-division

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Haig, R. M., op. cit., p. 231.
Ibid., Table 6, p. 20.
Ibid., Tables 4 and 5, pp. 18-19.
to the local governments. In illustration, twenty-five per cent of the revenue from the personal and corporation income taxes is retained by the national government, seventy-five per cent is distributed to the states on the basis of a budget formula, while each state, in turn, distributes at least fifty per cent of its share to communities in accordance with their relative need, seventy per cent of the yield of the turnover tax is retained by the national government, thirty per cent distributed to the states on the basis of a population and payment formula, with the state legislatures able to make further distribution to the localities if desired, four per cent of the yield of the automobile tax is held by the national government to cover costs of administration, and ninety-six per cent is returned to the states on the basis of a population, payment, and area formula, with the states required to use the funds for the public ways, all the inheritance tax revenue is retained by the national government.

France also has achieved substantial tax integration. The national government functions as the principal tax levying and collecting agency, sharing the revenues, in part, with the departments and communes.

While division of yield is a practicable method of achieving integration of our federal, state, and local tax systems as exemplified by the German and French fiscal practices, the difficulties confronting its adoption and the disadvantages inherent in the system make it less worthy of recommendation than the system of supplements or additions.

Under a plan of integration through the use of the method of supplements or additions, the primary tax administrative authority would be the Federal Government, as in the case of division of yield. The states, however, would be free to increase or diminish their proportion of the levies of the federally-shared and federally-collected taxes in correspondence with their needs. The local governments would be similarly treated in the levies of state-shared taxes. The rates of the various shared taxes would be elastic and would be changed in conformity to changes in the composite demand for revenue. Taxpayers would pay only a single tax of given form as, e. g., only one income tax, a single excise tax, and the like. This method of integrating the tax systems of our governments includes not only all the advantages of division of yield, which need not be repeated, but, in addition, provides for elasticity in revenues and meets the objection that division of yield is impracticable because the federal and state governments can not agree on the distribution formula. There would be also less in the way of state compulsion and subjection.
The system of integration through supplements or additions is not without weaknesses, however. If the tax rates of the income tax, for example, were uniform as to progression throughout the country and based upon the composite demands of the federal and state governments, objection could be made that some states were being taxed for the benefit of other states. The states, also, may attempt to load too heavy an addition upon one or all of the federally-administered and -shared taxes with a view of obtaining major relief for the property tax through the resharng of the revenue with the local units of government. On the other hand, if the supplement or addition by a state to a federally-administered tax applied only to the taxpayers of the state in question, there would be complications in the administration of the tax, interstate frictions occasioned by the apportionment and localization of interstate income and wealth, little or no equalization of governmental services between and among the states, and little or no improvement in the spreading of the tax burdens among the states in proportion to relative wealth and income, also, a reasonable balance between direct and indirect taxes, while obtaining in some states, perhaps, would not obtain in others, and government in the United States from a tax point of view would be treated as more or less unrelated parts rather than as a unity. Further, criticisms may be raised that the tax interests of certain states may not fit into the federal pattern, also, that a high degree of integration may preclude desirable state variation and experimentation in tax provisions and administrative procedures with a common form of tax. While these and other objections may be made to tax integration through the use of supplements or additions, it should be realized that no system of integration will be without certain weaknesses. However, the problems are by no means incapable of being solved. The objective is to select that procedure, or those combined procedures, involving the fewest theoretical and practical disadvantages, taken as a whole, capable of producing a properly integrated, unitary tax system.

Of the several proposals as to specific procedures to accomplish integration the system of supplements or additions appears most suitable if subject to adequate controls to prevent abuses. It is hardly to be expected, however, that the coordination and unification of the federal, state, and local tax systems will be brought about by the adoption of any single integrating procedure to the exclusion of all others, rather, it appears probable that various procedures may be combined to effectuate this result. The partial integration of certain state and local tax systems has been accomplished by the use of diverse methods. Professor Haig states that
integration in New York, to the extent achieved, has been through the withdrawal of the state general property tax levy, through grants-in-aid, and through sharing state-administered taxes with the local governments.\(^6\) In addition, the state attempts to regulate effectively locally-administered taxes. With the experiences and procedures of New York and other states in state and local governmental coordination of revenues to serve as guides to tax integration by the federal and state governments, a combination of grants-in-aid, division of yield, and, perhaps, supplements or additions may be used as the principal procedures to bring about the desired result.

It seems inevitable that thorough-going tax integration must soon replace the fiscal confusion, conflicts, and administrative wastes which characterize our present system as the pressure of economic and social forces operating to this end become greater. The severe fiscal pains and, on occasion, fiscal paralysis, evoked by the continuation of an antiquated fiscal system unsuited to the needs of the complex present-day economic and social order, should assist the public to obtain a better perspective by overcoming the existing political astigmatism. The improvement in the tax spread, the better balance between direct and indirect taxes, the provision of a measure of property tax relief, the reduction of tax administrative costs, the elimination of interstate tax conflicts and frictions, the higher minimum performance of governmental functions between and among states, the more effective state control of local taxation and expenditures, and the inducement of a greater measure of public respect for tax laws as end-products of proper tax integration are so important and necessary to the public welfare as not to be long in realization.

An argument advanced against tax integration is that it would prevent tax experimentation on the part of states. Conversely, it is said that the existing situation of non-uniformity and administrative duplication, while admittedly wasteful and a source of tax conflicts, is responsible for a substantial gain in the ascertainment, through experimentation by trial and error, of improved techniques in tax administration, of improved tax character as found in statutory provisions and features, and of greater knowledge of the incidence and economic effects of variations in the same general form of tax. It will be readily granted that our decentralized, haphazard, and illogical tax systems have not been wholly deficient,

\(^6\) New York Commission for the Revision of the Tax Laws, op. cit., p. 73.
and that some, although perhaps slight, benefits have been forthcoming in the way of certain desirable experimental results. It seems, however, that the net result has been "what not to do" rather than "what to do" in taxation. It has been negative rather than positive, restrictive rather than constructive. Error is present in the argument of the opponents of integration in the tacit assumption that a highly integrated tax system would preclude intelligent, farsighted, and constructive experimentation. In that the Federal Government is less susceptible to the exigencies of expediency, opportunism, and competitive tax considerations than the states, tax experimentation of the Federal Government should promise much more in the way of constructive results than equal experimentation by the states, also, experimentation relating to the property tax, for example, by the states should produce constructive benefits far more significant than proportionate experimentation by counties and townships with the same tax.

It seems questionable whether the tax practices of state and local governments should be dignified by the use of the term experimentation. If the term experimentation connotes reasonable foresight, intelligence, and a planned approach as applied to the tax problem, it appears to be a misnomer. State and local tax practices, in the main, have been the resultants of local neo-mercantilistic policies, competition, opportunism, short-sighted pressure politics, and expediency. In fruition these forces have produced legal, extra-legal, and illegal tax exemptions, subsidies and classifications, tax colonies, as in Florida, with the constitution prohibition against income and inheritance taxes, badly disequilibrated tax structures, excessive annoyance and expense to taxpayers, particularly interstate corporations, discriminatory taxation of a vicious character as exemplified by chain store sales and occupation taxes, and the like. In view of past and present experience with state and local so-called tax experimentation, the opponents of integration will do well not to press this argument. It should be taken *cum grano salis.*

There are various major difficulties confronting the establishment of an integrated tax system. It is not to be expected that there will be a clear, unobstructed path out of the present tax morass. The existence of dual sovereignties in government is a substantial obstacle to integration as the state governments, doubtless, will feel it incumbent upon themselves to preserve their quasi-independence, particularly in taxation, even though it is done at the expense and sacrifice of the welfare of their citizens. Considerable state opposition may be anticipated on the ground that integration
involves state subjection, relegation to a position of secondary importance, coercion and loss of function, patronage and "face." Public officials and others who are beneficiaries of the present system will allege a fundamental violation of "states' rights" even though such insistence means the violation of the rights of citizens to an orderly, balanced, and economical tax system. Efforts will be made to preserve formal rights at the sacrifice of basic economic and social considerations. State and local governmental political patronage found in tax administration is no mean consideration to those who will endeavor to preserve the status quo. These voices are so numerous that the very volume of noise will pass for profundity and will have effect in obstructing the path to integration. Public inertia is a passive force against which the proponents of reform, even intelligent reform, must contend. Fortunately, economic and social pressures are moving so strongly in the direction of integration that public inertia and lethargy are being shaken. There is no longer public apathy to the existing situation. It is likely to be contended that integration involves the taxation of one state or one region for the benefit of other states and regions. The correctness of the allegation will depend, of course, upon the character of tax integration and the distribution of the revenues. However, to those who believe in equalization of education and other social services performed by government, to those who favor spreading the tax burdens of the country in proportion to relative wealth and income it is not an objection, but, instead, a strong argument for integration. The principle of equalization of opportunity, particularly educational opportunity, has been accepted generally by states, and has been made effective by increasing the proportion of the individual state's contribution to common school support with distribution on some basis of relative need. There is fuller realization and appreciation of the fact that the economic and social welfare of those in one community, state, or region is closely interrelated with the welfare of those in other communities, states, and regions. In consequence, taxation for other states and regions does not constitute the bogey of the past. If we recall that distance is a function of time and that the friction of space has been nullified to the extent that we are economically and socially neighbors with one another, regardless of physical location, a proper perspective will be had. In commenting on this situation Professor Haig suggests that "cost, in time and labor, of overcoming the friction of space is, after all, the most important factor governing the economical size of the administrative unit. Today in these terms
the United States of America is much smaller than was the state of New York alone when the Constitution of the United States was adopted one hundred and forty-five years ago.64

There are, of course, beneficiaries of the present inequitable system who would oppose change. The legal complexity, conflicts, and constitutional and statutory violations developing out of our existing tax systems have fostered a host of "professional tax experts," "tax-fixers," and "tax attorneys" who have prospered and multiplied as the proverbial green bay tree. State and local officials, whose connection with the public payroll is through tax administration, would hardly wax enthusiastic over integration. Individuals and corporations whose taxable wealth and income are large and who are benefiting substantially through situs in tax colonies, through legal, extra-legal, or illegal discriminations, and the like, may approve integration in the abstract but not in the concrete. In illustration, on occasions, in dealing with the problem of inequitable property assessments in conferences and committees, we find the representatives of certain large corporations strongly endorsing improvement in assessment procedure. When, however, a concrete proposal, such as the centralization of all property assessments in the state tax commission is made, these representatives first qualify and hedge their endorsement, and then, if pressed, repudiate their prior assent. They agree that assessments, doubtless, would be more equitable under a centralized as compared with a decentralized system. On occasion, they state frankly that they are favored by the existing discrimination, that their "tax-fixers" have made satisfactory arrangements with the local assessors, and that under a more equitable assessment system their tax contributions, in all likelihood, would be larger.

There is a growing public conviction that the time has passed when the federal, state, and local governments may safely go their separate competitive ways in dealing with the tax problem.65 State and local tax officials confess their inability to deal with problems of tax administration hedged as they are by state and local boundaries. They complain of their futile efforts to establish


65 The New York Commission for the Revision of the Tax Laws unanimously recommended "that the legislature address a petition to the congress of the United States urging that a commission be established to consider the present relations between the revenue system of the federal government and those of the various state governments and to suggest such modifications in the existing arrangements as may seem desirable" in the "belief that the problem of the relations of the federal and state revenue systems is already serious and is likely to grow more serious with the passage of time." Report, 1932, Part 1, pp. 22-23.
equitable assessments for complex inter-county and interstate properties, to localize income for taxation, to prevent tax evasion, and to administer taxes in accordance with statutory intent. There is an appreciation of the fact that Gresham's law applies to competing tax systems as it does to currencies. The public advantage requires that government be visualized as a unit, that there be conscious coordination and integration in the largest and most important business of all, the business of government.