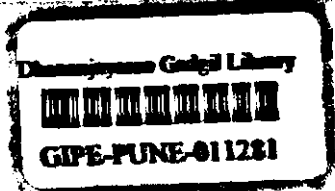


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**GENERAL SALES OR TURNOVER
TAXATION**

**STUDIES IN TAXATION AND
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GENERAL SALES OR TURNOVER TAXATION



NATIONAL INDUSTRIAL CONFERENCE BOARD, INC.
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PREFACE

THIS volume is one of a number of studies by the National Industrial Conference Board dealing with particular forms of taxation employed in the United States. Of this series, there has already appeared Volume I of a study, "The Shifting and Effects of the Federal Corporation Income Tax," dealing with the federal income tax on manufacturing and mercantile corporations. Volume II of this study, dealing with public utilities, building construction, banking and the extractive industries, is now in preparation. In addition, similar studies of other forms of taxation are now engaging the attention of the Conference Board.

The choice of general sales or turnover taxation as a subject in this series was motivated by two considerations. At the present time the legislatures of a number of states have under consideration the general sales or turnover tax, seeing in it a potential source of rich revenue that will relieve them of many of their fiscal worries. Because the tax is relatively unknown and untried in this country, there is a tendency in some quarters to view it as a sort of fiscal panacea. It is not unlikely that general sales or turnover tax laws will be enacted in several states within a few years' time. Under the circumstances a study of this form of taxation now has a strong element of timeliness.

The second consideration that influenced the Conference Board to make this study was the great dearth of information in this country upon the possibilities and limitations of the general sales or turnover tax. Treatises on this tax have appeared in several foreign languages, but none of these studies has been translated into English. A scanty polemical literature on the advantages and disadvantages of a federal turnover tax was published from 1918 to 1921, but these *ex parte* dissertations can be of little guidance to legislators or fiscal students seeking information on state turnover taxation. The National Industrial Conference Board

has in this report endeavored to make a genuine contribution to tax knowledge by a disinterested, non-partisan inquiry into the potentialities of the general sales or turnover tax.

In the preparation of this study the National Industrial Conference Board has greatly benefited by the cooperation and suggestions of its Advisory Committee on Taxation and Public Finance, composed of men of special knowledge and broad experience in this field, to whom the Conference Board wishes to express its indebtedness, *viz.*:

Addison L. Green, Chairman, Farr Alpaca Company, Holyoke, Mass., *Committee Chairman.*

Thomas S. Adams, Professor of Political Economy, Yale University, New Haven, Conn.

Paul Armitage, of Douglas, Armitage and McCann, New York City.

Arthur A. Ballantine, of Root, Clark, Howland and Ballantine, New York City.

Charles Cheney, President, Cheney Brothers, South Manchester, Conn.

Wilson Compton, Manager, National Lumber Manufacturers' Association, Washington, D. C.

James A. Emery, General Counsel, National Association of Manufacturers, Washington, D. C.

Charles W. Gerstenberg, Chairman of the Board, Prentice-Hall, Inc., New York City.

A. E. Holcomb, Tax Attorney, American Telephone and Telegraph Company, New York City.

James R. Knapp, Attorney, Union Carbide and Carbon Corporation, New York City.

L. F. Loree, President, Delaware and Hudson Company, New York City.

H. C. McKenzie, Tax Adviser, New York State Farm Bureau Federation, Walton, N. Y.

Fayette R. Plumb, President, Fayette R. Plumb, Inc., Philadelphia, Pa.

Herbert H. Rice, Assistant to the President, General Motors Corporation, Detroit, Mich.

Walter A. Staub, of Lybrand, Ross Bros. and Montgomery, New York City.

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J. Frank Zoller, Tax Attorney, General Electric Company,
Schenectady, N. Y.

William J. Shultz, Financial Economist of the National Industrial Conference Board, *Committee Secretary*.

Members of the Advisory Committee have generously contributed to the study of the subject under consideration, and have reviewed the manuscript, but their cooperation does not necessarily imply responsibility for all statements and conclusions expressed therein.

In the preparation of its studies, the National Industrial Conference Board avails itself of the experience and judgment of the business executives who compose its membership, and of recognized authorities in special fields, in addition to the scientific knowledge and equipment of its Research Staff. The publications thus finally represent the result of scientific investigation and broad business experience, and the conclusions expressed therein are those of the Conference Board as a body.

This study is a result of an investigation conducted by Mr. William J. Shultz, and assistants, of the Conference Board's Research Staff, under the supervision of the Staff Economic Council.

MAGNUS W. ALEXANDER
President

New York City
July, 1929

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GENERAL SALES OR TURNOVER TAXATION

INTRODUCTION

IT would be suitable and desirable to introduce a study of general sales or turnover taxation with a definition and a concise description of this form of taxation. Neither definition nor brief description, however, is possible; if it were, the greater part of this study would be unnecessary. The general sales or turnover tax is not a distinct and single form; it is a classification under which several individual and differentiated taxes have been drawn together and grouped on the basis of certain common features and similarities. Individual marked dissimilarities may perhaps cause the grouping to appear somewhat strained. This grouping is justified, none the less, for it permits a practical analysis of the possibilities and limitations both of the basic elements of general sales or turnover taxation and of the special and incidental features embodied in the individual taxes.

The characteristic of a general sales or turnover tax is that it attaches, directly or indirectly, to all commodity and property sales in prescribed general class or classes, such as sales at retail, sales at wholesale, manufacturers' sales, and so forth. Consequently, except for the special exemptions and discriminations, which are considered in the subsequent chapters of this study, it extends uniformly to all commodities and property entering into sales transactions. Taxes levied on the sales of particular commodities or properties—gasoline taxes, cigarette taxes or land transfer taxes, for example—are excluded from consideration; though they are "sales" taxes, they are not "general sales" taxes. The reasons for distinguishing these two types of taxes are several. Their legal foundations differ widely, their economic and social effects are not the same, and the administrative problems presented are distinct.

2 GENERAL SALES OR TURNOVER TAXATION

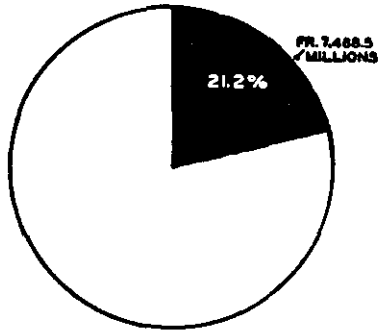
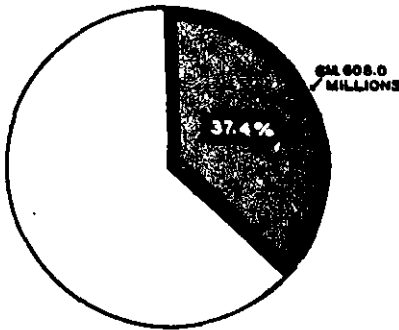
PRESENT PERTINENCE OF THE GENERAL SALES OR TURNOVER TAX

One of the speakers before the Senate Finance Committee in 1921 said of the general sales or turnover tax that it "constitutes the last resort of those countries which find themselves in such difficulties that they must subordinate all other principles of taxation to the one principle of adequacy."¹ Foreign experience during the eight years since 1921 has proved this generalization an exaggeration. The general sales or turnover tax in one form or another has become a major element in the tax systems of all the important European powers except Great Britain. It is found in a good proportion of the minor European countries. Of Asiatic states, Indo-China and the Chinese province of Shantung have recently enacted turnover tax laws. The general sales tax is a part of the Canadian dominion tax system and is found in several of the Latin American countries. A period of intense experimentation has taught the limitations of the general sales or turnover tax, but it has also indicated the administrative practicability of a moderate tax of this type—one of the chief points at issue. The only governments that, in recent times, have adopted a general sales or turnover tax and have subsequently discarded it are Yugoslavia, Lithuania, Latvia and the City of Danzig. On the other hand, the past few years have seen a steady pressure for the enactment of such a tax in Bulgaria, Holland and Greece.

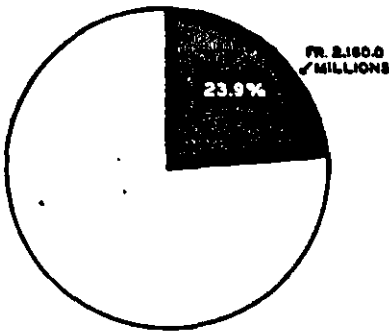
In the United States there was a strong movement from 1918 to 1921 for a federal turnover tax as a substitute for the excess profits tax, and possibly for some portion of the federal income taxes. This movement failed, and for the past few years the question of a federal turnover tax has been a dead issue. Heavy federal expenditures with consequent pressure on the revenue system may some time in the future raise again the issue of additional sources of federal revenue, and at such time the advisability of a federal turnover tax may again become a subject of contention.

¹ Prof. Edwin R. A. Seligman, speech in 67th Congress, 1st Session, Senate Finance Committee, "Hearings on the Revenue Act of 1921," p. 462.

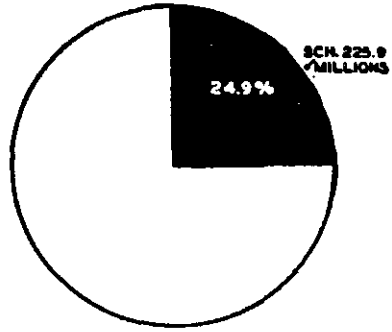
**CHART 1: GREATEST RELATIVE YIELD OF TURNOVER TAXES
IN FIVE FOREIGN COUNTRIES AND ONE AMERICAN STATE
GERMANY, 1923-1924 FRANCE, 1926**



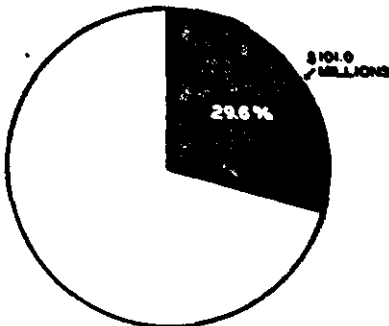
BELGIUM, 1928



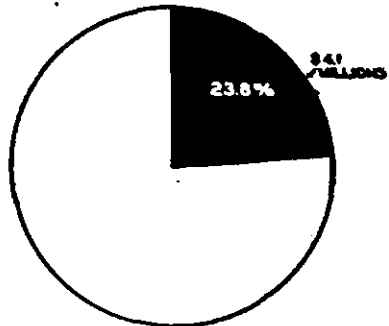
AUSTRIA, 1925



CANADA, 1923-1924



WEST VIRGINIA, 1926-1927



Note: Circles represent totals of national tax collections (for West Virginia, total of state tax collections) for given year. Segments represent proportions that turnover tax collections were of total tax collections.

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Of the states, one, West Virginia, has made the general sales or turnover tax a major element in its tax system. Three other states, Connecticut, Delaware and Pennsylvania, employ turnover taxes with restricted scope. St. Louis and Kansas City have experimented with municipal turnover taxes. Bills for general sales or turnover taxes were introduced at recent sessions of the legislatures in Missouri, South Carolina, Tennessee and Washington, but either died in committee or failed of vote in one or the other branch of the legislature; a turnover tax bill is now before the Georgia legislature. In California, Mississippi and South Carolina, special advisory tax commissions of recent appointment have given specific attention to the issue of general sales taxation; in California the report was unfavorable, but the commissions in Mississippi and South Carolina enthusiastically advocated turnover tax laws. In a number of other states, individual members of the state tax commissions, and in a few states the tax commissions as bodies, are advocates of this type of taxation.

American opinion, among scholars and laymen alike, has hitherto been generally uninformed as to the principles and possibilities of the general sales or turnover tax, and there has been little knowledge of the experience of the European countries, of Latin America and of Canada with this tax.

NOMENCLATURE

Although this species of taxation is of ancient origin and has an important place in the tax system of most foreign countries today, it is relatively unfamiliar to American fiscal experience. Not only is there ignorance or uncertainty as to its possibilities and limitations, there is confusion in the terminology applied to it. Two descriptive terms, practically synonymous and interchangeable, have developed—"turnover tax" and "general sales tax." Individual writers have sought to lay emphasis on one and exclude use of the other, or have endeavored to distinguish the two terms and to apply the first to one particular type of tax and the second to a different type of tax. Since there is no uniformity in these attempts at differentiation, and since both terms are suffi-

ciently broad to cover all of the special types of taxes in the general species, it would seem desirable to accept the two expressions "turnover tax" and "general sales tax" as synonymous and applying to all taxes based on the sale, exchange or transfer of commodities, properties or services. The terms are so used in this study.

The taxes which have been levied with "general sales" as a basis, abroad and in the United States, have in many cases differed widely from each other in form, scope and effects. For convenience of discussion, it is advisable to classify this broad group of general sales or turnover taxes into subtypes. A comprehensive nomenclature for these particular forms of general sales or turnover taxes is found in most Continental European languages; in English, however, such a nomenclature is lacking. For the purposes of this study, therefore, it has been necessary to assign arbitrarily certain terms to specific tax forms. Since the usage of a single study can not establish a terminology, the terms or names defined below may be accepted as earmarks temporarily attached to this series of taxes for the purposes of this study.

The general sales or turnover taxes that have been levied in the United States and abroad may be classified as follows:

Multiple-turnover taxes

General turnover tax

Commodity transfer tax

Single-turnover taxes

Production tax

Retail sales tax

Luxury turnover tax

The primary basis of classification for turnover taxes is according to whether the tax is imposed on several or all transfers or stages in the economic progress of a commodity or service, or whether it is imposed once, and once only, on each individual commodity or service. General sales or turnover taxes in the first category may be called *multiple-turnover taxes*. Those in the second category are *single-turnover taxes*.

The class of multiple-turnover taxes may be subdivided according to the scope of the tax. If the tax is limited to the sale or transfer of tangible materials and commodities, the

6 GENERAL SALES OR TURNOVER TAXATION

tax is a *commodity transfer tax*. If commercial or professional services, the sale or transfer of immovable properties, or other particular categories of transfers or services come within the scope of the tax, it may be called a *general turnover tax*.

Single-turnover taxes are to be classified according to the transaction that gives rise to tax liability. If the tax is imposed primarily on the sales made by producers or manufacturers, it goes by the name of *production tax*. If that which gives rise to the tax liability is the sale to the ultimate consuming purchaser, the tax is called a *retail sales tax*.

Finally, a general sales or turnover tax, single or multiple in character, may be restricted in its scope to the sales of articles and to the performance of services of a "luxury" character. Taxes of this sort, known as *luxury turnover taxes*, are generally levied as supplements to one or another of the broader forms of general sales or turnover taxation mentioned above.

SCOPE OF THE STUDY

The first seven chapters of this study are analytical, and present the possibilities, the limitations and the special developments of the general sales or turnover tax considered from its economic, social, legal and administrative aspects. Chapter I is devoted to consideration of the economic and social questions raised by the general sales or turnover tax: (1) whether or to what extent the burden of a general sales or turnover tax is shifted from the original payers of the tax to other elements of the population; and (2) how the burden of a general sales or turnover tax is distributed with regard to the tax-bearing ability of the various elements of the population. The economic and social effects of particular discriminations sometimes embodied in general sales or turnover tax laws are also covered in Chapter I. The constitutional and legal limitations on the levying of general sales or turnover taxes in the United States are dealt with in Chapter II. Chapter III covers the administrative problems raised by this form of taxation. Chapter IV is devoted to the application of the several forms of turnover taxation, with particular attention to their revenue aspect.

Chapters V and VI deal with special features of general sales or turnover taxation. It is believed in many quarters that this type of tax injects a discriminatory element into international trade. Countries levying such taxes have frequently made special provision to protect their domestic markets from the competition of foreign goods believed to be free of such tax burden, and to enable their own manufacturers to compete on even terms in foreign markets. These special provisions with regard to importation and exportation are considered in Chapter V. Chapter VI deals with the issues raised by luxury sales taxes. Chapter VII, the final chapter, presents in summary form the pertinent facts and principles, developed in the earlier chapters of the study, that apply to federal or state use of the general sales or turnover tax in the United States.

Two appendices give a short history of general sales or turnover taxation. Appendix I covers the history of foreign general sales or turnover taxes. The rudiments of this form of taxation found in the ancient medieval and early national turnover taxes are briefly indicated. Considerable space is given to the development of European general sales or turnover taxes after the World War, since the experience of these countries provides the tests on which judgment as to the advisability of this form of taxation must be based. The more limited American application of this type of tax is described in Appendix II.

CHAPTER I

ECONOMIC AND SOCIAL ASPECTS OF GENERAL SALES OR TURNOVER TAXATION

THE political expediency of any tax and its place in a tax system depend on the answers to two questions: Does the burden of the tax rest ultimately on the individual or business enterprise that initially pays it, or is this burden shifted to other elements in the community? Also, what relation does the final distribution of its burden bear to the distribution of wealth and income in the community? In the case of the general sales or turnover tax, inquiry into its economic and social aspects has been beclouded by partisanship, and in most cases the answers given to these two questions have been *ex parte* and do not offer sound legislative guidance.

THE GENERAL ECONOMIC EFFECTS OF TURNOVER TAXES

Those who opposed the federal turnover taxes advocated in 1921, attacked the proposals on the ground that a turnover tax would be shifted by tax-paying merchants and manufacturers to the consumers of their articles by incorporation of the tax in the price of these articles. One author, writing on the proposed general sales tax, stated flatly, "It is a tax on consumption, on expenditure."¹

Nevertheless, a common argument of the advocates of a general turnover tax at this time was that it would not be shifted to the consumer but that the burden of the tax would rest in major part on the tax-paying merchants and manufacturers. According to one writer:

"Now, if one bears in mind these two fundamental facts—the elasticity of effective buying power in the typical case and the presence of competition among sellers, is it not almost obvious that a sales tax

¹ Prof. Edwin R. A. Seligman, "The Sales Tax," in "Studies in Public Finance," New York, 1925, p. 136.

cannot be exactly shifted to the ultimate consumer through a precise advance in prices all along the line? It may be in part so shifted but it will be borne in no small degree by producers."¹

A later and more sweeping statement of this argument is presented in the following excerpt:

"Under many conditions, in fact under most conditions, this small tax will be absorbed in the overhead of business. The man . . . who sells large quantities of goods at very small gross profit, will practically be forced to add the tax at the bottom of his bill. On the other hand, the man who does a more moderate business with very large gross profit, will either voluntarily or by force of competition soon ignore the tax, so far as his selling is concerned, and consider it as part of his business overhead."²

The truth must be sought between the two contradictory theories, not in any broad eclectic generalization, but in the study and understanding of the specific circumstances that may favor the shifting of a turnover tax and of those that may prevent such shifting.

Effect of a Proportional Tax on All Sales to Consumers

To discover the effect of such a tax, let us assume a static economic society where the supply of commodities and services and the demand for them have reached a stable equilibrium, and where there is smooth competition among producers and sellers and among individual commodities and services for consumers' attention. A tax at a uniform rate is levied on the sales price of all goods and services sold to consumers. The tax is paid by the sellers, and their initial tendency is to add the tax to the price of each article or service they sell. Were the tax thus included in the prices of all goods and services, the competitive relations of these sellers would remain unchanged. Items originally costing the same would still cost the same; the prices of items differing in cost would still bear the same relation to each other after the inclusion of the tax in prices. From the sellers' side of the market equilibrium, there would appear to be no bar to this tendency to include the tax in the prices of all goods and services.

¹ William Andrew Paton, "The Pro and Con of a Sales Tax," *Administration*, Vol. II, p. 368.

² Hazen James Burton, "The Sales Tax," tenth edition, Minneapolis, 1927, page c.

On the demand side of the market equilibrium, the imposition of the tax raises the question whether a proportional increase in the prices of all goods and services, caused by including the tax in these prices, would in any way change the total or the distribution of consumers' demand. If the answer is affirmative, then it must be recognized that there are factors operative on the demand side of the market equilibrium that might bar the tendency of some sellers to include the tax in the prices they charge.

If the prices of all goods and services were raised by the amount of the tax, then the expenditures of each consumer would be increased proportionately to the rate of the tax, provided of course that he continued to purchase the same quantity and character of goods and services. The two categories into which an individual budgets his income are expenditures for consumption and for savings. If an individual continued to purchase the same quantity and character of goods and services at prices enhanced by the tax, thereby increasing the total of his monetary expenditures for consumption, he would necessarily decrease the amount of his savings. Whether the individual consumer would purchase the same quantity and character of goods and services after, as before, the tax, or whether he would maintain the quota of his savings and thereby reduce the quantity or change the character of his purchases of goods or services, depends upon which desire is the stronger—that of maintaining a given standard of savings or that of maintaining a given standard of consumption purchases. Making allowance for personal attitude, this issue depends largely on the income class to which the consumer belongs.

In the case of the poorest poor, who live from hand to mouth and whose income permits of no saving or reserves, consumption purchases are necessarily the sole items of their income budget, and the quantity or character of their purchases must vary as price changes affect the purchasing power of their income. A tax on sales to consumers would reduce and modify the consumption purchases of this element of the population, since it would, in effect, divert a portion of their income to the government as tax revenue.

The next general social class above this group includes the

greater part of the wage and salary earners, whose consumption purchases are not confined to bare necessities of subsistence and who succeed in putting aside savings which are small per individual but are very large in the aggregate. The savings of this class go into life insurance policy payments, payments on homes, building and loan association payments and savings bank accounts. With the exception of savings bank accounts, these forms of savings tend to have the character of fixed obligations. The imposition of a tax on the expenditures of this class will induce them to cut down on consumption purchases in order to preserve their savings.

The middle classes of the population retain somewhat of the same attitude of the sanctity of the savings account, but this tendency to assure a predetermined amount of saving at the expense of consumption purchases is not so marked as with the poorer classes.¹ In the case of the smaller number of the rich, their savings are the flexible element in their budgets, representing the margin between what they choose to spend and their incomes. A tax on their expenditures, therefore, would not affect their consumption purchases. Consequently, their monetary expenditures on consumption items would increase by the amount of the tax and their savings would experience a corresponding decrease.

For most individual consumers, and consequently for the consuming public as a whole, there is a large element of flexibility in the total demand for goods and services. If a tax should tend to increase the prices of these goods and services, instead of the total of expenditures increasing in proportion, there would be a decrease in the quantity and changes in the character of the purchases of goods and services. Would this reduction of the general demand for goods and services distribute itself as a proportional reduction in the demand for each particular commodity or service, or would it effect a marked reduction in the demand for some items and affect the demand for others little if at all?

¹ On this point some writers argue that since a consumption tax decreases the purchasing power of consumption expenditures without altering the purchasing power of investment expenditures, individuals in the middle classes will seek to derive greater value from their expenditures by devoting an increased portion to savings and a decreased portion to expenditure. Under this theory, the effect of a general sales or turnover tax in reducing consumption demand would be even more pronounced than the argument of the text would indicate.

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It is a matter of common experience that certain articles or services are purchased by individuals in approximately constant quantities, irrespective of outside circumstances. The basic necessities of life—non-luxurious food, clothing and shelter—have a steady consumption. The possibility of increasing their consumption is at most very mildly operative; pressure to decrease their consumption, unless extreme, is not effective. (The reduction of the general demand for goods and services which would result from imposing a tax on sales to consumers would not effect any marked change in the consumption of necessities for which there was a relatively inflexible demand. The whole brunt of the reduction would fall on the consumption of luxuries, of semi-luxuries, and of the improvements and embellishments upon necessities, for which demand is relatively flexible)

On the demand side of the market equilibrium the tendency to shift a proportional tax on the sales of commodities and services to consumers would thus affect the demand for articles and services of the necessity type little, if at all, but it would probably cause a decline in the demand for luxuries and semi-luxuries.¹ The original supply-demand equilibrium of the market would thus be destroyed. The subsequent

¹ Prof. Alfred G. Buehler, "Recent Developments of the General Sales Tax," *Journal of Political Economy*, Vol. XXXVI, p. 92. Prof. Buehler and others approach the problem of the effects of a general sales or turnover tax on demand by reference to the varying elasticities of the demand and price schedules of the individual goods and services which the individual consumer purchases. The tax, if shifted, they argue, would tend towards a proportional increase of all prices. A proportional increase in prices would reduce the demand for each item in accordance with the elasticity of its demand schedule, as this demand schedule existed prior to this tax and continued to exist after the tax. These changes in demand in return would require readjustments of supply, in the course of which the market would move to a new price equilibrium.

While the conclusions derived from this argument do not differ widely in their qualitative expression from the conclusions of the text of this volume, there is a sharp conflict between them concealed by the absence of quantitative statement. The fallacy in making the elasticity of the demand schedules of particular goods and commodities the basis for calculating changes in demand resulting from the imposition of the tax lies in the fact that the elasticity of an individual's demand for any particular article is itself determined by his demand for all other goods and services. The same price increase that is operating upon the individual's demand schedule for the particular commodity is operating simultaneously upon his demand for all other goods and services. Consequently, it is simultaneously altering the elasticity and character of the demand schedule of the particular commodity, and any calculations on its original elasticity and character are necessarily invalid.

Were the argument of the text and that based on the demand schedules of a particular commodity reduced to quantitative terms, the latter would result in a much smaller decrease in demand for non-necessities than the text argument.

readjustment of the supply would extend back from the dealers who sell these articles to their original producers. If the reduction of supply involved producers operating on a constant-cost basis, the reduction of supply would result in final prices for these items higher than the original prices by exactly the amount of the tax. If the producers involved operated on a decreasing-cost basis, the increase in price would be even greater than the amount of the tax, although where several points of equilibrium between supply and demand existed, the alteration in demand might well shift the actual market balance to a different point from the original, with a resulting price either higher or lower than the original one. If the producers operated on an increasing-cost basis, the increases in price would be less than the amount of the tax, or there might even be price decreases. These price changes resulting from the initial readjustments of supply would themselves become a basis for further readjustments of demand, until a new supply-demand equilibrium would evolve for the general market.

The general effect of a proportional tax on sales of commodities and services to consumers would be to establish a new, higher price level. The cases of lowered prices occurring through decreased production in an increasing-cost industry would constitute the exception rather than the rule. Although the readjustment of supply to altered demand in affected lines would not be without its reaction on business activities, a tax of the type so far considered would certainly not rest on the profits of particular business enterprises or of business enterprises in general. It would be essentially a consumption tax, resting on consumers and reducing the quantity or character of their purchases of goods and services.

Exception of Standard Price Articles

One broad exception to the general rule, that there is no bar from the sellers' side of the market equilibrium to the tendency for the tax to be included in prices,¹ should be noted. Many articles are sold at retail at standard fixed prices; the stock of a five and ten cent store would offer

¹ See p. 9 of this volume.

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numerous examples. In other cases, although there are no fixed retail prices, there is a tendency to peg retail prices at even sums—so many cents per pound or an even dollar or a dollar-and-a-half per item. In such cases, the producer or distributor must himself absorb the amount of the tax, or else give smaller quantity or poorer quality for his standard price. In many cases, even the latter alternative would be missing. A general sales tax, then, even of the hypothetical type considered so far in this section, would not be shiftable in so far as it applied to articles or services with standardized prices, but would operate to reduce sellers' profits.

The lower the rate of a turnover tax, the greater would be the difficulty of incorporating the amount of the tax in the prices of consumption goods, often sold at low prices per item and with a tendency to be priced at standard or round amounts. There would be a little difficulty in adjusting prices to include a tax of 50%, 25%, 20% or other such convenient fraction. To work a 0.1% or lower tax into the price of a standardized cake of soap, however, would be beyond merchandizing ingenuity. The merchant or producer would prefer to absorb the tax himself rather than upset his schedule of price or change his standardized unit of production. It is more or less recognized that "a low rate of tax stands in the way of its being shifted, because it is difficult to reckon the small tax on the price of each unit. A high rate of the tax, however, favors shifting, because the seller must shift it if he is to continue to exist."¹

Changing Market Conditions

Generalizations true in a static economic society do not always find detailed application in the dynamics of actual business movement. For example, the smooth, frictionless adaptation of supply to changes in demand, which is a major factor in the theory of the shifting and incidence of a turnover tax presented earlier in this section, finds no counterpart when actual market relations are unsettled by any outside element. Where pressure to include a turnover tax in prices threatened a reduction in the demand for specific

¹ Johannes Popitz, "Kommentar zum Umsatzsteuergesetze vom 26. Juli, 1918," Berlin, 1918, p. 11.

non-necessities, the supply of these articles would not promptly decline to equilibrium with the diminished demand. Instead, the producers and dealers would try to retain their market by absorbing the tax themselves at the expense of their profits. In such a buyers' market consumers might for a while obtain such articles free of any tax burden; if the demand for the article was an extremely flexible one, they might even for a time get it at less than producers' or dealers' cost. The producers of these articles, however, would not operate long on reduced profits or at losses. Eventually the weaker producers would be driven out of business or change their line of production; with a reduced supply on the market, the remaining producers would find that prices readjusted themselves so as to allow them a profit. In the long run, the imposition of a general sales or turnover tax would affect prices as described in the first pages of this section, but for a longer or shorter initial period, business enterprise might find itself bearing the burden of the tax.

It is sometimes argued that in a sellers' market, during a period of rising prices, producers and distributors take advantage of a general sales or turnover tax to pass on something more than the tax, whereas in a buyers' market, during a period of falling prices, they are compelled to absorb the tax themselves, thus adding to their losses. It is difficult to comprehend how a long-established turnover tax with a steady rate could have such effects. After the initial period of adjustments is past, a new market equilibrium is established, with prices generally higher, though not always by the exact amount of the tax. The tax soon sinks from the market's consciousness, and the development of the market proceeds as before, only at a higher price level. Therefore, it would be as reasonable to speak of the rent paid by producers or distributors as being an incentive to excessive price increases in a sellers' market, or as causing additional losses in a buyers' market, as it would be to impute these effects to a long-established turnover tax.

The situation is different, however, if the tax is *imposed* during a period of unsettled market conditions. Then, if

¹ See, Buehler, *op. cit.*, p. 92.

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there already exists an upward urge to prices, the imposition of the tax provides a convenient excuse for further rocketing. If the market is already dropping and producers and dealers are cutting prices to induce sales, the imposition of a turnover tax will not at first stay the momentum of falling prices. For a time, at least, the producers and dealers will have to bear the tax in addition to their other losses, and the destruction of weaker competitors will be caused or hastened. This consideration was forcibly placed before the Senate Finance Committee in 1921 as an argument against the levying of a federal turnover tax at that time.¹

Effect on Wages

Adam Smith argued that a "consumption tax," whether a general sales or turnover tax or a series of taxes on specific consumption commodities, would necessitate an increase in wages by the amount of the tax initially borne by the workers. He wrote:

"As the wages of labour are everywhere regulated, partly by the demand for it, and partly by the average price of the necessary articles of subsistence; whatever raises this average price must necessarily raise those wages, so that the labourer may still be able to purchase that quantity of those necessary articles which the state of the demand for labour, whether increasing, stationary, or declining, requires that he should have. . . ."

"It is thus that a tax upon the necessaries of life operates exactly in the same manner as a direct tax upon the wages of labour. The labourer, though he may pay it out of his hand, cannot, for any considerable time, at least, be properly said even to advance it. It must always in the long-run be advanced to him by his immediate employer in the advanced rate of his wages."²

The implication behind this argument, still occasionally cited by opponents of the general sales or turnover tax is that the minimum of human subsistence constitutes the supply price for labor that is dominant in setting the wage level; if this minimum of subsistence is reduced by a consumption

¹ See, Thomas S. Adams, "Needed Tax Reform in the United States," New York, 1920, p. 16; testimony of Prof. Fred R. Fairchild in 67th Congress, 1st Session, Senate Finance Committee, "Hearings on the Revenue Act of 1921," p. 418.

² Adam Smith, "The Wealth of Nations," Cannan edition, London, 1909, Vol. II, p. 355.

tax, the workers and their families will die off until scarcity in the labor market forces employers to raise wages sufficiently to cover the amount of the tax and so recreate a minimum of subsistence actual wage. This classic doctrine of the "minimum of subsistence" basis for wage schedules has been supplanted in modern times by the doctrine of the "standard of living" basis for wages. The "standard of living" basis for wages does not have the absolute automatic rigidity that was characteristic of the "minimum of subsistence" concept which led Adam Smith to his categorical conclusion that a tax on consumption by wage-earners must inevitably be covered by an increase of wages. It is, therefore, quite likely that a turnover tax representing a small burden on the consumption of wage earners would be absorbed by them through a restriction of consumption, or, less likely, through a decrease in savings, without inevitably forcing a wage increase.) A tax that absorbed any considerable fraction of wage-earners' incomes, and that seriously threatened their accustomed scale of living, however, might constitute grounds for agitation for wage increases to cover the tax.

This latter tendency would be emphasized if the tax were levied in a period of already rising prices with its concomitants of labor organization and agitation for higher wages. (The levy of the tax would be both a reason and an excuse for further agitation.) When the levy of a federal turnover tax was discussed in 1920, it was pointed out that the levy of the tax at that time "would strengthen the demands of wage earners for higher pay, act as an incitement to strikes, and in this way be passed along to the employers."¹

THE ECONOMIC EFFECTS OF GENERAL DISCRIMINATIONS

In practice, general sales and turnover taxes are not so levied that they constitute "a uniform rate on the sales prices of all goods and services sold to consumers." Discriminations may be embodied in a general sales or turnover tax by direct provision of the law or indirectly by the pyramiding or administration of the tax. These discriminations

¹ Adams, *op. cit.*, p. 16.

may be classified as (1) discriminatory tax burdens imposed on the sale of individual commodities and services or on classes of commodities and services, (2) discriminations between competing producers or dealers resulting from pyramiding of a multiple-turnover tax, (3) discriminatory tax burdens imposed on, or exemptions allowed to, general classes of producers or dealers, and (4) discriminations resulting from the levy of general sales or turnover taxes by territorially limited jurisdictions like state or city governments. Because of these discriminations, the economic effects of general sales or turnover taxes as actually levied vary from the effects of the hypothetical tax considered in the preceding section of this chapter.

Discriminations between Classes of Commodities or Services

The differences in the tax burdens imposed by a general sales or turnover tax on the sale of individual commodities and services or of general classes of commodities and services arise from two causes. The more important is the policy of exempting certain broad classes of commodities and services from turnover taxes for legal or social reasons. It is subsequently pointed out that the legal bases of many turnover taxes exclude the taxation of services, even though these services may enter into direct competition with commodity sales,¹ e. g., the labor of a tailor on a custom-made suit of clothes, when the customer supplies the materials, produces an article in direct competition with the sale of trade models. As is developed in a subsequent section² of this chapter, social considerations dictate the exemption of food-stuffs and other necessities, or at least their taxation at special low rates, in many turnover taxes. The levy of supplementary luxury taxes is an indirect means of accomplishing the same end.

A second cause of horizontal discrimination occurs in the case of multiple-turnover taxes and production taxes. It is shown later in the study³ that commodities of different classes vary in the number of turnovers they undergo between the raw material stage and their purchase as finished

¹ See p. 75 of this volume.

² See p. 40 of this volume.

³ See p. 117 of this volume.

articles by their ultimate consumers. A loaf of bread, for example, involves three turnovers, a suit of clothes at least six. Moreover, in the case of certain commodities, a large proportion of their final retail value may exist during their early turnovers, resulting in a much higher total tax than would be involved in the case of commodities with relatively low value until their final transfer. There is no established relationship between these two factors—the number of turnovers and the proportion of final value involved in the early transfers. In some cases they may offset each other, in other cases they may be mutually augmentative. In the final count they necessarily result in marked differences in the total tax burden on different commodities, both upon general classes of commodities and upon particular commodities within the general classes.

In a production tax, the number of turnovers does not affect final tax burdens, but the proportion of the final retail value represented by the production stage of different classes of commodities does affect them. Commodities whose production costs are the major element of their final retail value bear a heavier tax burden in proportion to final retail value than commodities whose distribution costs are the significant element.

Discriminations as to turnover tax burden between various commodities and services that result from specific provision of the law—the non-taxing of services because of limited legal subject, the exemption of whole categories of services or commodity sales for social reasons, the levy of a luxury turnover tax—usually apply to broad categories of services or commodity sales. The discriminations that occur through the pyramiding of a multiple-turnover tax or through the levy of a production tax, on the contrary, affect individual items of consumption. The economic effects of these two types of discrimination—the discrimination applying uniformly to entire categories of goods and services, and that operating on individual items—differ, and must be considered separately.

A discriminatory element of taxation on the sale of a particular commodity or service, if included in the price, will reduce the demand a greater or less amount according to the degree of elasticity of demand for that commodity or

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service.¹ In keying production down to the reduced supply required, the price will embody the tax, rise beyond it or fall short of it, according to whether the industry operates at constant, decreasing or increasing costs. Further adjustment of demand and supply to equilibrium may modify slightly but will not change the character of the price changes resulting from the initial adjustment of supply.

It may sometimes happen that there exists a practically identical substitute for the commodity or service discriminated against by the tax. This may be interpreted as giving the commodity discriminated against an extremely high demand elasticity, so that the slightest increase in price would result in a marked falling off in demand, its place being taken by the substitute. Another way of viewing the situation would be to interpret the two commodities as competitors for a single category of demand; the tax ends their competitive parity and the commodity discriminated against is threatened with the loss of its market. The production of the article discriminated against is decreased, that of its substitute is increased. If they are both produced at constant or diminishing cost, the commodity discriminated against will be driven completely off the market and the substitute will take its place at the same price. If both commodities are produced at increasing cost, however, the production of the first will decrease and that of the substitute will increase, until the lowered cost of the first plus the tax will just equal the increased cost of the second, and the two will then again compete on equal terms, but at a price higher than before. A discrimination in favor of any commodity would operate conversely.

These long-term effects of a discriminating tax burdening or favoring the sale of a particular commodity or ser-

¹ As a matter of strict reasoning, to use the common economic concept of "elasticity of demand" for a particular commodity or service in this connection involves an error of reasoning criticised before (see p. 12 of this volume, footnote 1), since any increased expenditure for a single commodity may modify the distribution of the total of an individual's consumption purchases, thereby modifying the character of the demand for all other commodities and services, and simultaneously modifying the original elasticity of demand for the particular commodity or service under consideration. The quantitative error involved in this line of argument when only a single commodity or service is involved is so small that it may be ignored, particularly in view of the circuity of the more correct "flexibility of demand" argument developed in the preceding section of the text.

vice, of course, do not ordinarily operate immediately upon the levy of the tax.) A special tax burden upon the sale of some commodity service, if not relatively large, will usually be temporarily absorbed, in whole or in part, by the producers or dealers in an endeavor to maintain their established markets. Since a competitive market equilibrium rarely if ever exists in fact, it may be that the tax discrimination will never operate upon the supply of the commodity but will result in a continuing slight reduction of the profits in that line of production. The one element of certainty in the situation is that producers and dealers will not escape some effect or reaction from the tax discrimination.

The economic effects of a discrimination, favorable or unfavorable, applying to entire categories of commodities and services differ from those of a discrimination on a particular commodity or service. An approach to the problem may be obtained by considering a discrimination applying to broad categories of commodities and services to act as a form of general sales taxation instead of as a form of particular commodity taxation. (A tax on a broad category of commodities and services, if shifted, would raise the prices of these items.) If demand for them remained unchanged, the consumer's total of consumption expenditures would be raised, and his savings reduced. But the consumer's savings resist reduction; therefore, purchases of goods and services would have to decline. This reduction of the consumer's total purchases would operate as a reduction of demand for those articles and services for which demand was most flexible—that is, non-necessities. However, the fact that the tax discrimination tended to raise the prices of a particular category of goods and services would operate as an additional repressive factor on the demand for the goods and services of this category, so that somewhat more than the average reduction of demand for goods and services in this class might occur. If the flexibility of demand for particular items of broad consumption in the category discriminated against were greater than that for other goods and services, the pressure of the price increase might well reduce demand for these particular items so much that opportunity would be allowed for a compensating increase of demand for items in other categories.

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These long-term shifts in demand in the market would result in readjustments of supply, which in turn would involve price changes reacting further upon demand and, consequently, on supply. In the case of discrimination in particular goods or services, however, the short-term effects of a discrimination on broad categories of goods and services might well be to reduce, temporarily at least, the profits of the producers of the particular items whose demand was reduced by the discriminations, the prices of these affected items remaining, perhaps, unchanged.

A discrimination in favor of a broad category of articles or services would have effects the reverse of those described above. The exemption of foodstuffs, for example, would save the prices of foodstuffs in general from being increased by the tax. This general saving to consumers might indirectly result in higher demands for non-necessities of all kinds than would have existed had foodstuffs been taxed together with other commodities and services, since the purchasing power preserved to consumers by the exemption would be expended generally on such luxury items. Because of the inflexible character of the demand for so many food articles, the producers of such articles might well be indifferent to whether or not an exemption was accorded to foodstuffs; (the producers of certain specialty articles in clothing or the purveyors of entertainment might, however, have their profits preserved to them by the exemption of foodstuffs.) Of course, consumers who expended a large proportion of their income on foodstuffs would unquestionably be benefited by the exemption, since just that much purchasing power would be preserved to them. Similar conclusions would be arrived at regarding the common non-taxation of services.

In general, any discriminations against or in favor of particular commodities or services or classes of such in a general sales or turnover tax, whether imposed by specific provision of the tax statute or resulting from the pyramiding of a multiple-turnover tax or from the operation of a production tax, modify the economic effects characteristic of a proportional tax on all sales and services to consumers. Unless the discriminations are so heavy and so broad as to

destroy the uniformity characteristic of a general sales or turnover tax, unless they transform it into a series of excises on particular items of consumption, they do not negative the general economic effects of the tax. To the extent that discriminations apply to particular commodities and services, they are likely in practice to react on the profits of the producers of these commodities and services in addition to causing readjustments in the consumer's budgeting of his purchases. To the extent that they apply to broad categories of goods or services, they tend to have no definite reaction upon the producers of the goods or services in these categories, though they may affect the business position of producers of non-necessities in general, for which consumers' demand is flexible. Of course, inasmuch as consumers in different income classes purchase relatively more or less of particular commodities and services, discriminations resulting in readjustments of demand and price for these particular goods and services may alter the effect of the general tax on the different income classes, lightening its burden on the poor or increasing it on the rich.¹

Competition between Single-Process and Multiple-Process Concerns

In the preceding discussions of the incidence and economic effects of general sales or turnover taxes, it was assumed that a particular commodity always underwent a given number of turnovers during its manufacturing and merchandizing process, although different commodities or classes of commodities might undergo more or fewer turnovers. Actually, there is no set number of turnovers for any commodity. A portion of the total amount of a commodity put on the market may have been produced by a multiple-process concern which covers all processes from the raw material stage to distribution to retailers or even to consumers, whereas the remainder may have been worked over by a series of independent single-process concerns and have changed hands many times before it reaches the consumer. Or, as between two commodities which are readily available substitutes

¹ For further development of the social aspects of general sales or turnover taxation, see p. 38 of this volume.

each for the other, the one may have been the output of a multiple-process concern, while the other was produced by a series of independent single-process concerns.

(A single-turnover tax would not discriminate between the output of a multiple-process concern and that of a competing series of independent single-process concerns.) In either case the commodity would be subject to turnover taxation once and once only, though the tax might be levied at the beginning of the industrial and merchandizing process, or at the end, according to the type of tax levied. (A multiple-turnover tax would apply to the product of a multiple-process concern only once—at the sale of the finished product. The output of its single-process competitors, each handling one stage of production or distribution, would be taxed at each turnover. Of course, unless the single-process concerns themselves absorbed the excess of the tax upon their product, it would reach the consumer burdened with a heavier tax than the product of the multiple-process concern.

This discrimination of multiple-turnover taxes has been pointed out again and again by opponents of this type of taxation. Its direct effect is to throw the excess of the tax on the product of the single-process concerns back upon the producers. (The pyramided tax can not be passed on to consumers through inclusion of the tax in the price.) Consumers will not pay a price including the pyramided tax if the identical article, produced by the multiple-process concern, can be had at a lower price because there is a smaller tax upon it. (The single-process concerns must either absorb the difference between the two taxes or lose their market.)

The indirect effects of this discrimination are twofold. First, the temptation arises to eliminate intermediaries in commercial transactions so as to reduce costs by the amount of the tax on turnover. Wholesalers and jobbers are the principal class to suffer from this tendency, since consumers and retailers are under an inducement to purchase directly from manufacturers. Of course, the tax discrimination alone will not suffice to eliminate all intermediaries. Dealers sometimes pose as commission agents of manufacturers and so evade the tax.¹ Moreover, at the present time, a greater

¹ *The Economist*, May 25, 1929, p. 1160.

inducement—the elimination of the intermediaries' profit—has not succeeded in offsetting the value of the intermediaries' services. The effect of the tax discrimination is rather to supplement any other factors tending to this end.

(The second effect of the discrimination would be to further the elimination of the independent single-process concerns competing with the multiple-process concern.) This elimination might come about through failure of the competing single-process concerns caused by the erasure of their profit margins by the tax they must absorb to maintain their market. The more probable method of elimination would be the consolidation of the independent concerns for the purpose of eliminating their turnovers. Here again, the effect of the discrimination would not be to inject an entirely new force into the current of economic development, but to supplement already existing tendencies, such as financial pressure to consolidate.

(It might conceivably be the direct purpose of a legislature to further consolidation and integration in industry and merchandizing by laying special burdens on intermediate and single-process concerns through multiple-turnover taxes,¹ but this has not been the case where legislative bodies have levied multiple-turnover taxes. This effect has usually been viewed as an unfortunate concomitant of the tax, to be avoided if possible. Two methods of avoiding the tax have been attempted—the levy of the turnover tax on separate processes carried on within a multiple-process concern, and the "consolidation"² of the pyramided turnover tax on individual commodities. The tax in the second case is paid in a lump at some particular stage of their industrial or merchandizing process, and thus is paid alike on the products of single-process and of multiple-process concerns.

¹ "The wholesalers are among the foremost of those who complain of this short-circuiting (of business by reason of the gross sales tax). It is worth considering, however, whether all branches of the wholesale business are really an absolute necessity, whether during the war and post-war periods many elements may not have crept in whose elimination is much to be desired."—Dr. Hans Luther, "Denkschrift über eine Abänderung der jetzigen Umsatzbesteuerung," Reichstag Drucksache, 1924, No. 558, p. 4.

² The term "consolidation" is here and subsequently used as the equivalent of the German term "Phasenpauschalierung," the literal translation of which would be "lump-summing."

The levying of a turnover tax on the separate processes carried on within a multiple-process concern has often been proposed in connection with the European turnover taxes, but the only examples of the application of this principle were given by the German turnover tax of 1918 and by the Czechoslovak turnover tax of 1923. The German law taxed the transfers between units of a multiple-process concern, providing that the turnover of the unit exceeded a given value. The Czechoslovak law provided that where the activities of a division of an industrial plant constituted a technical unit, normally carried on by independent concerns, the value of the product was subject to the tax if the annual value exceeded 50,000 kronen.

Insuperable administrative difficulties oppose this attempt to solve the problem. It is impossible to isolate all multiple-process concerns in order to subject them to the internal tax, and impossible to segregate the processes of such concerns for separate taxation. Fixing the values to be put on the separately taxable processes must necessarily be highly arbitrary. The ill will and dissatisfaction engendered by the attempt to extend a turnover tax to internal processes offsets any good effects that may result from the occasional successes of the procedure. In practice, neither Germany nor Czechoslovakia succeeded in carrying out its program for the internal taxation of multiple-process concerns.

The alternative possibility of eliminating the discrimination of a multiple-turnover tax against single-process concerns is to consolidate the normal cumulative taxes that would be paid by a series of single-process concerns, and to levy them in a lump sum on some particular industrial or merchandizing process, exempting all prior and subsequent processes. The same tax is thereby paid on the product of the single-process concerns as on that of the multiple-process concerns. Apart from solving a difficult economic problem, this procedure has a marked administrative advantage; it reduces the number of concerns subject to turnover tax liability and, consequently, the number of returns that have to be audited.

There are a few commodities with standardized processes of production and distribution for which there would be

little if any difficulty in thus consolidating multiple-turnover taxes. Sugar, flour and automobiles are suggested as examples. The normal number of turnovers can be ascertained; there is no uncertainty at any stage of production as to the ultimate character of the finished article. The productive and distributive processes of these commodities offer convenient points for the imposition of the consolidated tax—refining in the case of sugar, milling in the case of flour, manufacturers' sale in the case of automobiles. Such convenience of isolation of a line of productive and distributive processes, however, is the exception rather than the rule. In many if not most cases, it is impossible to determine what ultimate character will be given to raw materials and even to unfinished industrial articles.

An exemption of prior stages provided for in connection with the consolidation of the tax on one stage of an article may inadvertently exempt items entering into other articles; if the line is drawn too fine, the contrary result may obtain and the consolidation be only partial. To determine the total tax burden for each of a long series of articles is an arduous and politically dangerous labor; the door is thrown wide open to pressure by special interests for favoritism towards their particular industries. (The seeds of inextricable confusion are deeply embedded in the principle of general consolidation of multiple-turnover taxes.)

The Austrian turnover tax has put the principle of consolidation to its broadest application. The consolidated rate list of December, 1924 embraced 393 items, belonging to such classifications as food-stuffs, coal, coke and oil products, cotton products, flax products, wool goods, silk goods, articles of clothing, paper products and stationery items, leather products, wood products, glassware, stone and cement, porcelains, iron products, other commercial metal products, items of electrical equipment, motors and motor equipment, photographic equipment, musical instruments and so forth. Many of the 393 items were further subdivided into individual articles, and the full list took up 128 pages of the *Bundesgesetzblatt*. On some items the tax was collected on, and the rate of the tax was determined by, the value at the place of extraction—value at the mine in the

case of coal and at the spring in the case of mineral water; in the case of meats, the price "on the hoof" was the basis of the tax. In a great many instances the tax was based on the manufacturer's price; in the case of textiles, furs and leather goods the tax was laid on the wholesale price. Books, artificial flowers, musical instruments and other articles were taxed on the retail sale at the retail price. The consolidated rate varied necessarily according to the number of turnovers of the commodities taxed, and according to the stage at which they were taxed. The average consolidated rate was $2\frac{1}{2}\%$, with a few items under 2% and a few items over $5\frac{1}{2}\%$. The turnover taxes of Czechoslovakia and Hungary provided for similar general consolidation though not on such an extensive scale.

That the consolidation of multiple-turnover taxes is not categorically impracticable is evidenced by the willingness of these countries to retain the system. However, the problem is much simpler in these three countries, limited in territory and not as yet deeply industrialized, than it would be in larger countries of a more industrial character. When the Austrian method was suggested as a means of relieving the discriminations of the German turnover tax, the Chancellor admitted the partial success, at least, of the Austrian experiment, but argued that the system would collapse miserably in more industrially advanced Germany.¹

Consolidations of multiple-turnover taxes on a limited scale have been applied to the Belgian, French and Italian turnover taxes. A Belgian law of January 2, 1926 provided for a flat 2% rate on vegetable products, butter, by-product animal foods and fertilizers and flax. Bread grains, coal and coke products and exported flax were covered by a flat 1% tax. Later royal decrees consolidated the turnover tax on a number of specific articles, mostly food stuffs. France consolidated its turnover tax on meats, coal and coke in 1924 and subsequently extended the system to tea and coffee, manures, sugar, imported sulphurs, flour and its by-products. The Italian turnover tax of 1923 provided consolidated rates on meats and wines.

The consolidated taxes of Belgium, France and Italy are

¹ Luther, *op. cit.*, p. 6.

to be distinguished from those of Austria, Czechoslovakia and Hungary on two grounds. In the first group of countries, consolidated rates are provided for a limited group of articles that present minimum technical difficulties; no attempt is made to expand the method into an all-inclusive system. Secondly, whereas the consolidated rates of the Austrian, Czechoslovak and Hungarian taxes are adjusted so as to approximate the cumulative burdens of the turnover taxes on the series of single-process concerns in each line of production, the Belgian, and Italian taxes have set flat arbitrary rates bearing slight relation to the actual burden of the cumulated turnover tax. The consolidated taxes of these three countries are primarily a method of achieving horizontal discrimination favoring the segregated commodities, and only secondarily a method of eliminating the discrimination of the tax against single-process concerns.

As far as the United States is concerned, consolidation in either federal or state turnover taxes on the broad Austrian model would be out of the question; the complications would so rob the tax of essential simplicity as to make it unworkable. There are, however, possibilities in the Belgian and French system applied to a limited number of standardized articles; the rate might be fixed so as to approximate the cumulated burden of the turnover tax itself on these items, or for social or other reasons special rates might be applied as in Belgium, France and Italy. The effects on importation and exportation of consolidating a general sales or turnover tax are considered in a later chapter.¹

Discriminations between General Classes of Producers or Dealers

A classification of industrial and business activity into categories such as extractive industry, manufacture, wholesale merchandizing, retail sales and so forth, and the application of differing tax rates to the sales in the various stages of commodity production and distribution does not result directly in a differentiation of tax burdens on commodities as they are purchased by the consumer. A limited turnover tax of this character gives no one commodity or class of commodities an

¹ See pp. 131, 135 of this volume.

advantage over others. To the extent that commodities and classes of commodities differ as to the relative contribution of their various stages to their final retail values, however, a discrimination between general classes of producers or dealers may result indirectly in a discrimination between commodities. The exemption of manufacture, as in the Pennsylvania Mercantile License Tax, discriminates against those classes of commodities which have a high cost of distribution. The setting of a special low rate on wholesale transfers, generally characteristic of American state general sales or turnover taxes, modifies the original discrimination of a turnover tax in favor of articles sold directly by manufacturers to retailers or consumers. Whether the discriminations between commodities thus resulting from discriminations between general classes of producers or dealers affect the distribution of the tax burden as between producers and consumers depends on the principles of shifting stated in preceding pages.

Turnover Tax Levies by Limited Jurisdictions

From the supply side of the market equilibrium, the possibility of shifting a turnover tax by including it in consumers' purchase prices depends upon the imposition of equal tax burdens upon all units of a commodity and its substitutes. (If a turnover tax has sufficient territorial scope to reach all goods produced and distributed to the general market, then all units of any commodity and of its substitutes will come under the tax and the tax will tend to be shifted, allowing for variations in demand, as discussed in the preceding pages. If the territorial scope of the tax is so limited that the tax reaches only a fraction of the product entering into the general consumers' market, then part of the supply of a commodity and its substitutes will enter the market free of turnover tax, and the possibility of shifting the tax is reduced.

Such writers as have dealt with this issue have written as though the problem involved only the levy of a general sales or turnover tax in one state and the absence of such a tax in other states. Thus, a West Virginia tax commissioner wrote of the 1921 Gross Sales Tax of that state:

"The West Virginia manufacturer, shipping his goods to competing markets, likely finds himself absorbing the tax burden, for the reason that his Pennsylvania or Ohio competitor's goods reach the market with no sales tax added. Assuming, therefore, that the conditions in West Virginia and neighboring states are equally favorable for the manufacturers of the competitive articles, the West Virginia manufacturer will bear the cost of the sales tax. The tax in this case is in effect, not a sales tax, in the accepted sense of the word, as used with reference to the proposed federal tax—a consumer's tax; but it is a privilege tax, pure and simple."¹

It should be recognized, however, that the problem of competition between taxed industrial and business enterprises located in one state and untaxed concerns located in another state is not peculiar to general sales or turnover taxation, but arises with all taxes (except net profits taxes, which in general are not shiftable and do not affect competitive relations) paid by business enterprises operating in an interstate market. In the absence of any organized exposition in textbooks or other fiscal writings of the economics of taxes levied by limited jurisdictions, attention has been given here, first, to a formulation of the general doctrine of the incidence of taxes levied by limited jurisdictions and, second, to the particular application of this doctrine to state and local turnover taxes.

Assume that conditions of industry and business in state A and in state B are similar and that the industrial and business enterprises of the two states compete in a general interstate market. Assume also that state A levies a tax (other than a net profits tax) which is paid entirely or in part by industrial and business concerns—a general property tax, perhaps, or a capital stock tax on incorporated concerns, or a general sales or turnover tax—while state B levies no tax whatsoever on industrial or business concerns. Each of these taxes would differ from the others as to the relative tax burden it would impose on particular enterprises or classes of enterprises in state A. Their effects would correspond, however, in that each would impose a general tax burden on the enterprises of state A not borne by the enterprises of state B.

¹Walter S. Hallanan, "West Virginia Sales Tax, A Year's Administrative Experience," National Tax Association, "Proceedings of the Fifteenth National Conference," 1922, pp. 108-109.

The taxed concerns of state A may well wish to include the tax in the prices of their goods and so maintain their previous standard of profit. Their products, however, must compete in the general interstate market with the identical or substitute products of the untaxed enterprises of state B. These latter, presumably competing among themselves, will not be induced to raise their prices because a tax, in no way affecting their costs, has been levied in state A. The taxed enterprises of state A will therefore have to meet the prices set by the untaxed enterprises of state B; they will have to absorb the tax themselves, thereby reducing their profits, or lose their hold on the common market.

The taxed enterprises of state A may originally have had certain advantages—cheaper power, a better labor market, superior distribution facilities—which made their costs lower than those of the untaxed enterprises of state B. In such case, the reduction of their profits by the imposition of the tax may still leave them a standard of profit as high or higher than that of the competing concerns of state B. No change in the circumstances of their doing business will result. But suppose that the enterprises of state A enjoy no advantages giving them a higher profit standard than the enterprises of state B; it may well be that for some lines the concerns of state A are marginal, their gross incomes barely covering their costs and leaving little, if any, profit. The imposition of the tax by state A may seriously reduce their profit, or eliminate it altogether and force losses upon them. In some cases the concerns so situated will fail and their more fortunately situated rivals in state B will take up their output. In other cases, where the enterprises of state A are mobile, they will remove to state B and establish themselves there.

In practice, industrial and business enterprises are rarely subject to a single state and local tax and they never find themselves in competition with rivals in other states paying no taxes whatsoever. Instead, the tax burden on the industrial and business enterprises of any state is likely to be a cumulation of several independent or supplementary taxes, each of which exercises its own peculiar discriminations between types of industrial and business activity and be-

tween individual concerns. A general property tax (in administrative practice largely a real property tax as regards industrial and business enterprises) or a real property tax imposes a relatively high ratio of tax costs to selling prices on those classes of industrial and business enterprise and on those individual concerns which have a heavy investment in land and buildings in proportion to turnover. Any form of corporation tax discriminatingly burdens concerns conducted under a corporate form of organization. A capital value tax burdens most heavily those corporations which have a high ratio of invested capital to turnover or net income. A general sales or turnover tax, from the point of view of investment or net income, discriminates against those enterprises which seek profits on their investment through large turnover with small profit per unit sold.

Every state levies either a general property tax or a real property tax which is paid by manufacturers and other business concerns. Most states also levy at least one other tax which must be paid by business enterprises, either directly or incidentally. The manner and extent to which the competitive position of any class of enterprise or of any individual business concern is affected by the taxes levied in its state depends, first, upon the way the combination of the discriminations of the particular taxes paid operates upon it in view of its special circumstances, and second, upon the proportions of its total tax burden resulting from the payment of several individual taxes.

(The distinctive discrimination of a general sales or turnover tax is that it bears most heavily upon classes of enterprise and upon concerns with large turnovers relative to their capital and to their net profit.) A manufacturing or mercantile enterprise with a small turnover in proportion to capital and net profit located in a state levying a general sales or turnover tax may find that its tax costs bear no greater relation to the prices of its goods than those of its competitors located in states deriving their revenues from other types of taxes. A firm with a large turnover in proportion to its capital and net profits located in a state levying a general sales or turnover tax, however, will find its tax costs higher in relation to the sales prices of its goods than

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those of its competitors in other states, provided that there is some comparability in the rates of the taxes in the several states. The excess tax cost resulting from the general sales or turnover tax can not be shifted and therefore reduces the profits of the taxed concerns. This discrimination of the general sales or turnover tax against industrial and business enterprises with relatively large turnovers involves two groups of concerns—those belonging to categories of industrial or business activity which generally operate on large turnovers in proportion to investment and net profits, and those particular enterprises whose turnovers in proportion to their capital and net profits are larger than the average in their line.

The differing ratios of turnover to net profits and to capital investment for various categories of industrial and business enterprise are indicated in data collected by the National Industrial Conference Board. Over a four-year period of normal business activity, 1922 through 1925, the annual average for the ratios of the profits of a selected group of manufacturing corporations to their sales varied between 7.4% and 9.4%. The annual average ratios of profits to sales for a comparable group of wholesale corporations for the same period varied between 2.6% and 3.5%. For a group of retail corporations during the same year, the ratios varied between 6.2% and 6.8%.¹

Differences in the ratios of capital to turnover for this selected group of manufacturing, wholesale and retail corporations were also marked. For 1922 and 1923, two years of normal business activity, the ratio of the average capital to the average turnover of the manufacturing corporations was around 80%, for the wholesale corporations it was slightly above 30%, and for the retail corporations it was about 40%.² Clearly, (if a state levied a flat rate general sales or turnover tax, its wholesalers would be burdened more than its manufacturers, where both groups were competing with rivals located in states basing their taxes on net profits or some element of capital value) According to

¹ National Industrial Conference Board, "The Shifting and Effects of the Federal Corporation Income Tax," New York, 1928, Vol. I, p. 189.

² *Ibid.*, pp. 216, 222.

the rate of the turnover tax of the first state and the rates of the capital value taxes of the other states, it might well be that the turnover tax placed manufacturers at no competitive disadvantage as compared with rivals in other states, whereas wholesalers might have an excess tax burden, as compared with their rivals in other states, which they would be unable to shift.

Where the industrial and business enterprises burdened by a general sales or turnover tax had to compete with concerns in other states levying net profits taxes, the entire amount of the turnover tax paid by all lines of activity would constitute an unshiftable excess burden, because the net profits taxes of the other states would not enter the prices of the goods produced and distributed by the concerns of these states; the discrimination would still be greatest upon the wholesalers of the state levying the turnover tax, because of their proportionately greater turnover.

A classification of the rate of a turnover tax according to types of enterprises reduces this discrimination against wholesalers and other high-turnover types of industrial or business enterprise operating in an interstate market. A scientific classification of rates would need to be based upon a statistical calculation of the difference in the ratios of net income and capital or realty values to turnover for each class of enterprise, and would eliminate any discriminations of the turnover tax as between classes of enterprise. Then, whether the industrial and business enterprise of the state levying the turnover tax would be forced to bear any of the burden of the tax would depend upon the rate of the tax as compared with the rates of taxation in other states where competitors were located. The issue would not turn upon the character of the turnover tax levied in the first state, but upon the general business tax burdens of the several states. If the classification of rates were unscientific—if the rates on the various classes of activity were haphazardly or arbitrarily fixed upon—the modification might fall short of, or overreach, the goal of equalization, and the turnover tax itself would continue to discriminate more or less against one or another class of enterprise.

The rate classifications of the American state and local

turnover taxes, with the exception of the West Virginia tax, are arbitrary. The West Virginia tax was adjusted in an indirect, but satisfactory, manner for differences in the ratios of net income to turnover,¹ but not for differences in the ratios of capital or realty values to turnover. Consequently, it does not equalize between classes of industrial or business enterprise where they compete with enterprises located in states taxing on a capital value or general property basis. Moreover, it should be noted that the vertical discriminations in the American state turnover taxes were not enacted with a view to neutralizing special burdens on business faced with foreign competition, but were provided with a vague intent to equalize the burdens of the turnover taxes on business in the state—the view being mistakenly held that because from a legal or constitutional point of view the turnover taxes were “business” taxes, as a matter of economics they therefore constituted a final burden on business enterprise. Consequently, it is by accident rather than design that the discrimination of state turnover taxes on high turnover classes of enterprise competing in interstate markets is generally lessened by rate classifications.

Not only does a state turnover tax place entire categories of enterprise, such as wholesale merchandizing, in a disadvantageous position compared with rival enterprises in other states; it operates similarly against individual enterprises with turnovers larger in proportion to capital or net income than the average for their line. Where such an individual concern is competing with similarly developing concerns in other states which levy their taxes on some other basis, it is likely to have to pay a heavier tax than its competitors. No type of rate classification will neutralize this discrimination. It must not be overlooked that the concerns thus penalized by the turnover tax tend to be the more active and progressive ones which are seeking to create growing markets for their goods by taking small profits on large turnovers and to achieve the economies of large-scale production.

Throughout this discussion of the economic effects of general sales or turnover taxes levied by limited jurisdictions, it

¹ See p. 195 of this volume.

has been assumed that the industrial and business enterprises whose sales are taxed sell their goods in an interstate market. In the case of mining, extractive and manufacturing enterprise, this assumption is generally valid. Granted that there are small producers who serve a local market and never sell outside local boundaries, nevertheless, these local producers must in many cases meet the competition in their local markets of large-scale outside producers. The market that is local for the resident producer is a part of the interstate market of outside producers. The discriminations of state or local turnover taxes noted above apply in their fullest degree to extractive and manufacturing industry.

Different factors operate in so far as state or local turnover taxes rest on merchandizing. The retail dealer's market is generally local. All his immediate competitors must pay a like tax on their turnovers. He does not have to compete with rivals who, because they are taxed under different tax systems, have a smaller element of tax cost to consider in their selling prices. (In general, all units of each taxed commodity and its substitutes pass to consumers with the same tax burden.)

Two exceptions must be noted to this generalization as to the effect of a general sales or turnover tax upon local retailers. Such dealers must compete, to a certain extent, with mail-order houses located in other states that do not levy general sales or turnover taxes. The tax raises the sales cost of the local dealers' goods by the amount of the tax. Mail-order houses have a much larger turnover in proportion to capital investment or net income than local retail establishments; therefore, it is improbable that the taxes they pay in their own states on other bases than sales result in a higher tax cost to sales price than the general sales tax which the local retail dealer must pay. The mail-order house can deliver its goods to customers in the state with a smaller tax cost than the local retail dealers. If the hold of the mail-order house on the local market were large, local dealers might have to absorb all or part of a tax on their sales or see the mail-order house capture their market. In general, however, the mail-order house has no such hold on the local market, and a moderate tax on the sales of local

dealers does not have to be absorbed to save their market; the mail-order house merely obtains a further, but by no means decisive, advantage in its competition with the local merchants.

The second exception occurs where contiguous communities are separated by a state boundary. A certain amount of retail shopping then occurs across the boundary. If the retail dealers of the one community have to pay a tax on their sales and those of the other community are taxed on some other basis, a discrimination exists against those dealers in the first community who are working with large turnovers in proportion to their capital and net profit.

Wholesalers do not operate in so free an interstate market as do manufacturers, but they must concern themselves with interstate competition more than retailers. The "interstate commerce limitation," however, prohibits the state of their location from taxing their sales to customers in other states not levying turnover taxes¹; in fact, this exemption required by the law is a strong competitive factor in their favor since no compensating tax is usually laid on them to offset the exemption. According to their lines, however, they may have to meet competition from turnover-tax-free wholesalers from outside the state who have entered and are selling in their own state. To the extent that they must meet such competition, their situation is analogous to that of the manufacturers discussed above; unless there is vertical discrimination, all wholesalers in the state are likely to suffer from a general sales or turnover tax; a special discriminatory tax burden rests on the sales of those who seek a large turnover in proportion to investment.

SOCIAL DISTRIBUTION OF TURNOVER TAX BURDENS

A blanket charge is often laid against the general sales or turnover tax that it disregards the currently accepted principle of "ability," that it burdens the poorer classes of the population more than the richer classes.² This sweeping charge does not take into account the differences in distribu-

¹ See p. 70 of this volume.

² See, Seligman, "The Sales Tax," pp. 136-137; Buchler, *op. cit.*, p. 96.

tive effect of different types of general sales or turnover taxes, nor the place of these taxes in the general revenue system.

The General Rule

A general sales or turnover tax which imposed a proportional burden on all commodities and services purchased by consumers would in general raise the prices of these goods and services, though not always by the exact amount of the tax, and would involve a decrease and a redistribution of consumption demand. If all individuals had equal incomes and, allowing for individual preferences, made consumption expenditures similar in amount and distribution, a general sales or turnover tax of the type here considered would impose the same tax burden on all individuals, a social distribution of the tax burden with which no one could quarrel. Thus, a Russian writer, commenting upon the turnover tax and other indirect taxes levied in Russia under the soviet regime, writes, "It should not be forgotten that the Russian population has to a large degree been reduced to a common level, so that indirect taxation does not bear that anti-democratic character which it does in capitalistic countries where sharp inequalities of property exist."¹

Inequality of wealth and income, however, is the rule in the countries of Western Europe and in the Americas. It is a truism that the proportion of an individual's income devoted to consumption expenditure decreases as his relative income increases. The higher-income classes of the population in general are able to devote a larger proportion of their incomes to saving and investment, and they do save and invest relatively more than the poorer classes. Where individuals differ in the amounts of their consumption expenditures, the burden on each of a general sales or turnover tax not embodying any discriminations is roughly proportional to the respective consumption expenditures; differences in the distribution of the consumption expenditures mar the proportionality slightly but do not destroy the general relation. Hence, a proportional tax is laid upon a larger

¹ G. Sokolnikoff, in *Manchester Guardian Supplement*, July 6, 1922, p. 225.

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part of the total income of poorer individuals than of rich individuals. In proportion to the total incomes of individual consumers, the burden of a general sales or turnover tax rests heaviest on those consumers with small incomes and lightest on those consumers with large incomes.

The Effect of Discriminations between Commodities and Services

To the extent that differences in the burdens on particular commodities and services affect rich and poor differently, they modify the distribution of the burden of turnover taxes as described above. The discriminations between commodities and services inherent in all multiple-turnover taxes, resulting from differences in the number of turnovers for various classes of commodities, operate to burden the poorer classes relatively heavier than the richer classes. The cheaper, standardized, machine-made products that enter largely into the consumption of the poorer classes pass through more hands than the specialty and custom-made purchases of the rich. A multiple-turnover tax is levied upon the former classes of commodities on more occasions than upon the latter classes; the cumulated tax on the former necessarily represents a larger proportion of their retail value. Consequently, to the extent that this factor operates, a multiple-turnover tax does not impose a proportional burden on consumption expenditures, let alone on income; the burden of the tax even in relation to consumption expenditures decreases as the amount of an individual's consumption expenditure increases.

Moreover, apart from investment payments, a portion of the expenditure of the rich is for services which are not taxed by commodity transfer taxes, production taxes or retail sales taxes. The following comparison of the distribution of expenditures made from a \$20,000 income and from a \$2,000 income, as they would be burdened by a 3% retail sales tax that embodied no statutory discriminations as between commodities, illustrates this point:¹

¹ Chester A. Jordan, "The Sales Tax," *Bulletin of the National Tax Association*, Vol. VII, pp. 182-184.

1. EXPENDITURE DISTRIBUTION OF \$20,000 INCOME AND BURDEN OF A 3% RETAIL SALES TAX

Purpose	Amount	Tax
Food.....	\$2,000	\$60
Manufactured clothing.....	1,000	30
Custom clothing—material.....	300	9
Custom clothing—labor.....	300	9
Habitation costs.....	3,000	90
Servants.....	2,500	none
Automobile upkeep—material.....	500	15
Automobile upkeep—labor.....	1,000	none
Vacation.....	500	none
Amusements.....	500	25
Taxes.....	1,000	none
Charities.....	2,000	60
Miscellaneous.....	2,000	60
Investment.....	3,400	none
Total.....	\$20,000	\$358

2. EXPENDITURE DISTRIBUTION OF \$2,000 INCOME AND BURDEN OF A 3% RETAIL SALES TAX

Purpose	Amount	Tax
Food.....	\$720.00	\$21.60
Clothing.....	500.00	15.00
Rent, heat and light.....	600.00	18.00
Miscellaneous.....	180.00	5.40
Total.....	\$2,000.00	\$60.00

If the investment expenditure from a \$20,000 income is counted in, the 3% retail sales tax amounts to only 1.79% of the total expenditure of this income, whereas for a \$2,000 income the burden is the full 3% of the tax. When investment payments are excluded, the burden on the consumption expenditures from the \$20,000 income is 2.16%, still considerably lower than the burden on the expenditure of the \$2,000 income.

As against these tendencies of general sales or turnover taxes to burden disproportionately the poorer elements of the population must be set the almost universal practice of exempting, or at least of taxing at special low rates,¹ food-stuffs and other items that constitute the major portion of the expenditures of the poorer classes but a smaller fraction of the expenditures of the richer classes. If the renting of dwellings, as a service, is untaxed, and foods are entirely exempted, the entire distributive character of a general turnover tax is changed. The poorer classes are practically entirely relieved of its burden. The richer classes are, of

¹ See p. 45 of this volume.

course, also relieved of the tax to the extent that they make expenditures for food and shelter. These items, however, constitute a smaller proportion of the total of their consumption expenditures, so that their relative gain from the exemption is much smaller.

Another possibility of offsetting the tendency of a general sales or turnover tax to burden the poorer classes more heavily than the rich lies in the levy of a supplementary luxury turnover tax. To the extent that expenditure on luxuries is greater, in relation to income, by the rich than by the poor, a luxury turnover tax may lay a compensating tax burden on the rich classes. Offsetting disadvantages of the luxury turnover tax are considered elsewhere in this study.¹

The Effect of Failure to Shift Turnover Tax Burdens

When a turnover tax is not shifted in individual instances, these considerations of the distribution of tax burdens between classes of consumers do not apply. A turnover tax that is not shifted directly or indirectly reduces business profits for a shorter or longer time according to the circumstances of the industry or business, possibly in individual cases to the extent of destroying it. A tax that reduces the profits of business enterprises is a burden on the income of the owners of these enterprises, whether their ownership is that of individual proprietorship, partnership or corporate shareholder. Individual and partnership ownership of business enterprises and ownership of corporate shares are found to a greater extent among the higher-income classes than among the lower-income classes. Therefore, an unshifted turnover tax reducing business profits bears almost exclusively on well-to-do individuals, though there is no smoothness or regularity in the heavier burdens it places on the higher-income classes.

The Place of a Turnover Tax in a General Tax System

Any form of general sales or turnover tax not embodying specific discriminations levied by a national or federal government will be shifted to the consuming public, allowance

¹ See Chap. VI of this volume.

being made for the effects of the unequal pyramiding of multiple-turnover taxes, for the discrimination of multiple-turnover taxes in favor of multiple-process concerns and against single-process concerns, for standard-price articles, and for friction in the readjustment of supply to reduced demand in certain lines. A retail sales tax levied by a state or local government will also be generally shifted to consumers, allowance being made for the competition of mail-order houses and of retailers in adjacent states. The social effect of such taxes will be to impose a heavier tax burden on the poorer classes of the population than on the rich. This circumstance directly contradicts the currently accepted doctrine that, where special benefit from specific governmental functions can not be proved, taxes should be levied according to the principle of "ability to pay." That a shiftable general sales or turnover tax embodying no remedying statutory discriminations, standing by itself, fails to qualify under the currently accepted principle of "ability," does not, however, forthwith condemn it as an element of a federal or state tax system.

If the other parts of a general tax system tend to bear heaviest on the rich classes—if it is otherwise composed of personal income taxes with graduated rates, inheritance taxes or estate duties with graduated schedules, or unshiftable business taxes—these elements may counterbalance the contrary tendency of the turnover tax. On this argument, the European countries justified their imposition of turnover taxes during the post-war period, since they were already levying heavy progressive direct taxes dating from the war era. If the United States Federal Government were to need more revenue than that provided by its present tax system, the progressive character of the present system might be considered a justification for the levy of a turnover tax. The present state tax systems, however, for the most part already tax heavily the poorer elements of the population.¹ Few, if any, states could argue as justification for a retail sales tax, the only certainly shiftable form of state turnover tax, that its heavy burden on the poorer classes was offset by

¹ See, National Industrial Conference Board, "Cost of Government in the United States, 1925-1926," New York, 1927, pp. 126-132.

exceptional burdens on the rich from other parts of their tax systems.

The issue that usually faces legislators is that of choosing between a turnover tax and some other form of tax to raise a required revenue. The proposition may be to substitute a general sales or turnover tax for some other tax already in existence, or to raise an additional quota of revenue by a turnover tax or by some other tax. If the alternative tax is one that levies, or would levy, a burden relatively heavier on the richer classes than on the poorer classes, then under modern fiscal theory the expediency of substituting a general sales or turnover tax for it is open to serious question. If, however, the alternative tax also would in the long run burden the poorer classes of the population more than the rich, and if the choice of the legislature is restricted to this tax and a turnover tax, then the heavy burden placed by the latter on the poorer classes might be ignored and the decision be based on other factors. A state retail sales tax as a means to relieve a portion of the general property tax burden might be justified where, if the tax were considered *per se*, it could have little support.

To the extent that the tendency of a shiftable turnover tax to overburden the poorer classes is modified by the exemption of foodstuffs and other necessities or by the imposition of a supplementary luxury turnover tax, the social arguments against it are correspondingly weakened.

If a state or local government levies any other form of a general sales or turnover tax than a retail sales tax, there is a strong probability that it will not be entirely shifted. Types of industrial or business enterprise, such as wholesale merchandizing, which have large turnovers in proportion to invested capital, will find themselves in competition with lower-taxed rivals in other states and will have to absorb the tax themselves. Classification of the rates of the tax, however, may go far toward curing this defect. No manner of rate classification or modification, however, will neutralize the competitive discrimination of a state or local general sales or turnover tax against individual concerns with turnovers relatively larger than the average for their lines.

SPECIAL DISCRIMINATIONS

None of the general sales or turnover taxes actually levied has been a pure example of a retail sales tax, a production tax, a commodity transfer tax or a general turnover tax. In all cases, special discriminations incorporated into the tax laws have modified their general character and effects. These special discriminations may be classified into six categories: (1) Social discriminations, intended to alter the normal tendency of turnover taxes to burden the poorer classes more heavily than the rich; (2) rate classifications, intended to modify the injustices of non-shifted turnover taxes as between types of industrial or business activity; (3) economic discriminations, intended to relieve or favor certain classes or types of industrial or business activity; (4) cultural and charitable discriminations; (5) discriminations in favor of governmental or public activities; and (6) administrative discriminations. The last named type of special discrimination is treated separately in Chapter III.¹ Discussion of the first five types follows.

Social Discriminations

The normal tendency of general sales or turnover taxes to burden the poorer classes more heavily than the rich has been modified in many instances by taxing sales of foodstuffs and other necessities at lower rates than other sales, or by exempting such sales altogether. Of the modern European turnover taxes, those of Belgium and Italy exempt the necessities of life generally, the Roumanian tax exempts sales of breadstuffs and meat, and the French tax exempts breadstuffs, milk and bread grains. The Polish tax levies the special low rate of 1% on foodstuffs; the Czechoslovak tax also has a special low rate for foodstuffs and meat. The Canadian turnover taxes, though they have changed their character radically during their eight years' history, have consistently accorded liberal exemptions to all items that might be considered "necessaries of life." The Latin-American turnover taxes and those of Porto Rico and the Philippine Islands do not tax sales of foodstuffs.

¹ See pp. 92 ff. of this volume.

If a turnover tax is of such character that it will probably be shifted wholly or in large part to consumers, the desirability of effecting a better social distribution of its burden by exempting necessities or by taxing them at a special low rate must be balanced against the fiscal and administrative disadvantages of such discrimination. The yield of any turnover tax will be sharply cut by the exemption of foodstuffs and other necessities. Moreover, this discrimination lays additional burdens of reporting on producers and dealers, it adds to the labor of the administration of the tax, and it offers considerable possibilities for evasion. Retailers, in particular, must keep a double set of accounts, the one for taxable sales, the other for exempt sales. There is an ever present temptation for them to color their accounts, while keeping the figure for their total turnover correct, by reporting a portion of their taxable sales as exempt. This deception would be difficult for the administrative authorities to uncover.

Since it is the social character of the tax system as a whole, and not of any given tax, that constitutes the major problem of the distribution of tax burdens, the German approach to the issue of distributive discrimination would appear to be the most practical. The German turnover tax makes no discrimination in favor of foodstuffs or necessities, but depends upon the progressive character of other elements of the German tax system to offset the burden of the German turnover tax on the poorer classes.

Rate Classification by Types of Business Enterprise

The exemption or special taxation of broad types of economic activity is an inherent element of the turnover taxes levied by the American states and localities. The West Virginia Business Occupation Tax discriminates between extractive production and manufacture. Different rates are applied to manufacture and to merchandizing in the turnover taxes of West Virginia, Connecticut, Delaware (which taxes retail merchandizing at the same rate as manufacture, but has a special rate for wholesale merchandizing), Pennsylvania (which exempts manufacture but taxes wholesale and retail merchandizing) and the city of St. Louis. A

discrimination in the rates on wholesale and retail sales is effected in all of these state and local turnover taxes. The only examples of vertical discrimination offered by European turnover taxes are those of Italy and Luxembourg, which exempt all retail sales. The Brazilian turnover tax is, in general, lighter on wholesale transactions than on retail sales.

The advantageous effects of rate classification in neutralizing the competitive discrimination of a state or local turnover tax against wholesalers and other high turnover enterprises has been indicated earlier in this chapter.¹ In addition, a good case for the exemption of retail sales could be made out on administrative grounds. Such an exemption would eliminate a multitude of insignificant tax accounts whose checking and supervision must be excessively expensive compared with the revenue derived, if widespread evasion is to be avoided. A slight advantage might be given to those commodities whose proportionate retail merchandizing cost is above the average, with a corresponding disadvantage to commodities with retail merchandizing costs below the average, but the discrimination so worked would not be serious.

Economic Discriminations

The attempts to eliminate the discrimination of multiple-turnover taxes against single-process industries by consolidating the tax or by internal taxation of multiple-process concerns has been described.² Other major forms of economic discrimination found in modern turnover taxes are (1) the exemption or favoring of agricultural production, (2) the favoring of the basic industries, (3) the favoring of special businesses or types of business activities, and (4) the favoring of cooperative associations.

All the European countries except Germany, Belgium, Austria and Czechoslovakia exempt sales of farm products by their raisers as do also the turnover taxes of Canada and of the Latin American countries. The turnover taxes of the American states are strictly limited to industrial and commercial activities. The reasons for favoring agriculture

¹ See p. 35 of this volume.

² See pp. 26 ff. of this volume.

in turnover taxation are often political, but such favoritism can be sustained on economic grounds. The dominance of demand factors in setting the prices of farm produce, because of the inability of the agriculturalists to control and determine their annual output, the competition of grains and even meats in an international market, and the relative inflexibility of agricultural capital, place the farmers in an unfavorable position to shift any taxes levied upon them. Even where a general sales or turnover tax is relatively shiftable, such part of it as is paid by farmers on their sales is likely to rest on them. Where the effort and aim of many modern governments is to aid agriculture, it would be illogical to burden the farmer with a new, additional tax.

The case for special favorable treatment of the basic industries is different and not so strong as that for favoring agriculture. It can not be argued that the basic industries occupy an economically disadvantageous position. Moreover, there is little likelihood that they would be unable to shift freely and easily their share of a turnover tax. The argument for exempting semi-raw materials and crude industrial products is to encourage industrialization by eliminating the tax element from the prices of the materials consumed by industry. At best this is a weak and administratively unsound expedient. The only turnover tax law embodying it is the Polish.

Many countries provide for the exemption of independent small-scale and handicraft activities. Russia allows a blanket exemption to all industrial and handicraft activities carried on by individuals without assistants. France and Czechoslovakia exempt the output of household industries. France, the Latin American countries, the Philippine Islands and Porto Rico exempt peddlers. The use of the tax power to further particular economic or social ends of this type is dangerous, since it is an open invitation to special interests to exercise political influence upon legislatures to shape tax laws to the advantage of particular groups. Moreover, the favoring of individual and handicraft activities as against organized business concerns has the flavor of an attempt to block the course of economic progress in order to curry political favor. Administrative considerations may warrant the

exemption of small producers and dealers, but exemption for administrative reasons should be based on a figure for annual turnover and not on methods of conducting industrial or business enterprises.

In those European countries which levy turnover taxes and in which development of cooperative purchasing or selling associations has made headway, these associations have exerted considerable pressure, vigorously opposed by the business interests of the countries, to have their sales exempted from turnover taxation. The only country which at present allows a blanket exemption to the sales of cooperative associations is Belgium. Soviet Russia taxes the sales of cooperative associations at one half the regular rates. In France the issue came before the courts and was long delayed there; since 1926, however, all cooperative associations except agricultural syndicates have been taxable on the sum total of their sales. One argument made for exempting the sales of cooperatives is that their existence involves an extra transfer of the commodities they deal in, so that to make their sales subject to a turnover tax would be to discriminate *against* them. The very purpose of these associations, however, is to eliminate middlemen and their profits, so that the existence of a cooperative association does not add to the chain of taxable transfers, but merely effects a substitution. The only valid argument for exempting their sales would be to encourage them for social reasons, and there are better and more effective means of accomplishing this end than by tax discrimination.

Finally, a special short-lived discrimination of the German turnover tax is of interest. The German tax law of 1919 allowed a rebate to those merchants paying turnover taxes on their sales who had dependent children under the age of sixteen. The rebate was graduated directly according to the number of such dependent children and inversely to the net income of the merchant. It is not evident whether this provision sought to give a special tax relief to providers for large families or whether it was intended to stimulate the German birthrate. For whichever purpose, it was ill-advised, leading to administrative complications. It was abolished one year after it was enacted.

Charitable and Cultural Exemptions

Institutions of charity perform services; their dealings in commodities are, at most, incidental. Therefore they would be subject to a general sales or turnover tax only if it were of the general turnover type. In Germany, Austria and Czechoslovakia, whose general turnover taxes extend to professional and other services, all services of a charitable character, if not performed for a profit, are exempted.

An alternative or supplementary method of relieving charitable institutions of turnover tax burden would be to provide that sales by dealers and merchants to such institutions should be exempted from turnover taxation. Thus they could obtain goods and materials at a price lower than the market level by the amount of the tax. The disadvantage of such a provision would be administrative. The fewer special exceptions that a dealer has to take account of in reporting his taxable turnover, the lighter is his accounting labor, the easier is the checking problem of the administrative authorities, and the smaller is the likelihood of evasion. These considerations have deterred all governments from incorporating such an exemption in their turnover taxes to date.

The taxation of services under a turnover tax embodies a special threat to the arts, since the tax that an artist, a writer, or a tutor would pay on the sale of his services probably could not be conveniently shifted. Even where it might be possible to shift the tax on such services, their value to the cultural development of the country would warrant their encouragement by exemption. So in Germany, Austria, Czechoslovakia and Russia, where such services would otherwise be taxable, they are specially exempted. While the sale of concert tickets is generally exempted in these countries, the sale of theater tickets is taxable. In France and in Germany this favorable treatment is extended to the sale of newspapers.

Discriminations Favoring Governmental or Public Activities

Most countries exempt outright all sales by governmental bodies and public utilities. A few follow the lead of Germany and limit the exemption on governmental activities to a

narrow group of services, not including the public utilities. In the United States, the Federal Government might extend a turnover tax to its own services, and the states to theirs, including state and local public utilities, but implied constitutional limitations forbid either to extend any tax to the services or activities of the other.¹

There is a balance of argument against levying a turnover tax upon the activities or services of governmental departments. Two departments—the department performing the service and the tax department—are involved in collecting a charge for the service performed by one. The duplication of activity is wasteful and unnecessary. However, additional considerations apply in the case of public utilities. If not actually in competition with private concerns, they may at least be considered as substitutes for such. Exemptions and special privileges in the case of government operated utilities becloud the issue between such utilities and privately operated concerns. If the latter are taxed by a turnover tax, the government operated utilities should operate under the same burden.

Because of the implied constitutional limitation in the United States that the state governments can not tax the instrumentalities of the Federal Government, and vice versa, there is the possibility that sales to the state and local governments and their agencies might be exempt from a federal turnover tax, and that sales to the Federal Government might be exempt from state turnover taxation. In a recent case bearing upon the latter situation, the United States Supreme Court in a divided opinion held a state tax on gasoline sold to an agency of the Federal Government invalid under the implied constitutional limitation.² The five to four division of the judges on the issue, however, would indicate that it is not entirely closed.

CONCLUSIONS

This chapter has sought to answer two major questions regarding the general sales or turnover tax: (1) Does its

¹ See, further, p. 72 of this volume.

² *Panhandle Oil Co. v. Mississippi*, 48 Sup. Ct. Rep. 451.

burden rest ultimately on the individual or business enterprise that initially pays it, or is this burden shifted to other elements in the community? and (2) What relation does the final distribution of its burden bear to the distribution of wealth and income in the community? Since the economic and social factors involved are many and complicated, a brief decisive answer to either of these questions is not possible. The considerations involved in the issue may be summarized under the two headings of economic and social effects.

Economic Considerations

The conditions governing the supply of and the demand for manufactured commodities and their price point to the conclusion that a general sales or turnover tax exactly proportioned to the retail prices of taxed commodities and services would raise the prices paid by consumers, though not necessarily by the exact amount of the tax. The uneven effect of the tax on prices would result, not from any peculiar circumstance of the general sales or turnover tax, but because the resulting reduction of consumers' purchasing power would lead to a diminished demand for luxuries and non-essentials. The shrinkage of supply that would follow would affect the prices at which these articles and services could be placed on the market, according to the circumstances of their production—that is, whether they were produced at constant, increasing, or decreasing cost.

In practice, however, general sales or turnover taxes do not burden commodities and services exactly proportional to their retail prices, except in the case of retail sales taxes. A multiple-turnover tax—one that is levied on articles more than once in their progress from initial producers to consumers—would, because of its pyramiding, burden some articles heavier than others. Consumers would tend to purchase fewer of the more heavily burdened articles and more of those lightly burdened. Temporarily, the producers and distributors of the first group of articles would find their profits reduced, and producers and distributors of the second group would find their profits increased. After a time the supply of each group of articles would adjust itself to the modified demand. Price changes would follow, according

to the circumstances of the production of the affected articles.

A multiple-turnover tax would also tend to discriminate among producers and distributors. A multiple-process concern, combining many productive and distributive processes, would be taxed only on its finished output. A series of independent-process concerns in the same business, each concern handling one productive or distributive process, would have to pay the tax on each process. The independent-process concerns would thus bear a special unshiftable tax burden, their profits would be reduced, and a further inducement would be given to business consolidation. Austria eliminates this discrimination against independent-process concerns by consolidating the pyramided tax on each article to a single rate, which is paid alike on the output of multiple-process concerns and of the series of single-process concerns. This system would seem to be inapplicable in the United States because of its administrative complexity.

Three temporary effects of the levy of a general sales or turnover tax should be noted. First, the reduction of consumers' demand for luxuries and non-essentials which would result from the levy of a general sales or turnover tax might be met by a price reduction on the part of the producers and distributors, in the hope of retaining their markets. Until the supply of the affected articles readjusted itself to the changed demand, these producers and distributors would suffer reduced profits and possibly outright losses. Second, a general sales or turnover tax levied during a period of general depression, with demand dull and prices perhaps declining, could not be added by producers and dealers to their prices without further reducing their sales; temporarily, therefore, the tax would fall on the producers and dealers. Conversely, a turnover tax levied during a boom period might cause producers and dealers for a time to add somewhat more than the tax to their prices. Third, the prices of articles marketed at low standard prices might not be affected by a general sales or turnover tax if its rate was low, since a small fractional tax could not be conveniently added to the price, and since any change in the price would sacrifice market good-will. If the tax continued long, it might be possible

for the producers and distributors of such articles to effect a shifting of the tax by readjustments in the quantity or quality sold at the standard price.

The levy of a general sales or turnover tax by a state or local government would in many cases impose a particularly discriminatory tax burden on wholesalers, as compared with their competitors located in other jurisdictions not levying such a tax. Since wholesalers could not shift this discriminatory tax burden, they would have to absorb it as a reduction of their profits. This discrimination might be eliminated by taxing wholesalers at a lower rate than other types of business enterprise. Furthermore, a state or local turnover tax would place individual industrial and wholesale concerns with large turnovers in proportion to their capital values at a competitive disadvantage with their rivals in other jurisdictions not levying turnover taxes. Retailers would not be so affected by state or local turnover taxes, except as they competed with mail-order houses, or with retailers in neighboring jurisdictions levying no turnover taxes.

Social Considerations

A general sales or turnover tax would be essentially a consumption tax. It would tend to increase the prices of goods purchased for consumption more or less by the amount of the tax. Consequently, in proportion to their incomes, it would tend to burden the poorer classes more heavily than the richer classes, because the consumption expenditures of the former absorb a relatively larger proportion of their incomes, and because a considerable proportion of the expenditures of the latter are for services which are not subject to many forms of turnover taxation.

Because of this circumstance, the social and political opposition to the general sales or turnover tax is strong. This opposition might be modified if it were proposed to combine a general sales or turnover tax with some other tax which imposed heavy burdens on the rich classes and a light burden or no burden at all on the poor classes, such as a graduated personal income tax with large exemptions. The two taxes would thus supplement each other to form a balanced system. Opposition to the general sales or turnover tax might also be

less if it were proposed to substitute it for another tax which, for social or administrative reasons, was less satisfactory than the general sales or turnover tax itself.

Were a luxury turnover tax administratively practicable, such a tax would offset the burden of a general sales or turnover tax on the poorer classes. As is subsequently indicated, however, the luxury turnover tax has not been found to be a workable supplement to the general sales or turnover tax. The only expedient manner of reducing the burden of a general sales or turnover tax on the poorer classes seems to be to exempt foodstuffs and other necessities from the tax, or else to tax them at a special low rate. A larger proportion of the expenditures of the poorer classes than of the richer classes are for these necessities. Consequently, the poorer classes would gain a major benefit from such an exemption, whereas its effect upon the rich classes would be minor. Such an exemption, however, would entail certain administrative disadvantages; these are considered in a subsequent chapter.

CHAPTER II

CONSTITUTIONAL ASPECTS OF GENERAL SALES OR TURNOVER TAXATION

GENERAL sales or turnover taxes, abroad as well as in the United States, are levied under the taxing power of the State. Although this power is broad enough to cover all forms and aspects of such taxation, the federal and state constitutions in the United States impose restrictions and limitations on the possibilities of turnover taxation which are not encountered abroad. Three sets of constitutional limitations must be taken into account—the limitations of the Federal Constitution on the possibilities of federal turnover taxation, the limitations of the Federal Constitution on the possibilities of state and local turnover taxation, and the limitations of the constitutions of the individual states on their own powers of turnover taxation.

A preliminary exposition of the legal theory of “subject” and “measure” in taxation is essential to comprehension of the American doctrine of constitutional limitations. Subsequently, a section is devoted to each of the sets of constitutional limitations noted above as they apply to federal, state and local general sales or turnover taxes. A final section of this chapter deals with the time and place of turnover tax liability.

THE DOCTRINE OF “SUBJECT” AND “MEASURE” IN TAX LAW

At first glance, little uniformity can be found in the application of constitutional limitations to federal, state or local tax laws by the American courts. One tax is upheld. Another, apparently identical in its character and effects, is held to contravene some limitation.

The language of the cases does not always afford a clue to the yardsticks employed by the courts in determining

whether or not the tax before them is subject to some constitutional restriction. Analysis of the legal character of the taxes which have been upheld or rejected by the courts, however, brings to light a distinction which the courts have specifically or tacitly held in mind when passing on tax cases, and which endows the modern decisions on the constitutionality of tax laws with a strong element of consistency and uniformity. The distinction in question is between the "subject" and the "measure" of a tax.¹

The "subject" of a tax is the category of persons, property rights, privileges or acts upon which the tax is levied or the existence of which gives rise to tax liability. The "measure" of a tax is the standard or scale by which the amount of the liability is determined.² Thus a state personal income tax on residents may have persons as its "subject," and the income of the individual taxpayer as its "measure"; a state capital stock tax on foreign corporations may have the privilege of doing business within the state as a "subject," and use as a "measure" the capital stock of such corporations employed within the state; an

¹ See, Elcanon Isaacs, "Business and Property Taxes," *Yale Law Journal*, Vol. XXXVI, pp. 195-206; "The Subject and Measure of Taxation," *Columbia Law Review*, Vol. XXVI, pp. 939-953; "Constitutional Aspects of Taxation," *American Bar Association Journal*, Vol. XIII, pp. 125-129. Cf., Lewis H. Porter, "State Excise Taxes as Limited by the Federal Constitution," *National Tax Association*, "Proceedings of the Sixteenth National Conference," 1923, pp. 116-124.

² A further distinction is necessary between the "measure" of a tax and its "determinant" or "standard of allocation"—the standard used to restrict a "measure" of a tax in practical application broader than its "subject" to within the scope of the "subject." Thus, in a state net income tax on foreign corporations, the "subject" of the tax is the privilege of doing business in the state as a corporation, and the "measure" of the tax is the net income derived from business done within the state. The methods of business accounting may not permit of direct ascertainment of the amount of net income derived from business done within the state. To obviate this difficulty, the tax law may provide that net income derived from business done within the state shall be determined by the proportion of the business assets of a corporation within the state to its total business assets. This proportion or ratio is the "standard of allocation" or the "determinant" of the tax.

The constitutional limitations which may apply to the "subject" and "measure" of a tax never apply to its "determinant." Failure to recognize this distinction between the "measure" and the "determinant" of a tax caused Mr. Isaacs, in the articles noted above, to deny consistency to the courts in some of their tax decisions on an issue where they have displayed particular acuteness of vision.

The problem of "standards of allocation" or "determinants" does not arise in the law of general sales or turnover taxation because sales values can be directly attributed to particular states without the intervention of special "standards of allocation." The issue is mentioned here for the sake of completeness in the discussion of the general background of constitutional limitations on state and local tax power.

inheritance tax may have as its "subject" the transfer of property from the decedent to his beneficiaries (an act), and employ the value of the property so transferred as a "measure." The elements of the "subject" and the "measure" of a tax may differ from each other, as in the illustrations given above, or they may coincide, as in the case of the federal personal income tax which, under the Sixteenth Amendment, is levied on income as a "subject" and is measured by the amount of such income.

In passing on the constitutionality of state and local taxes under the limitations of state constitutions, the state courts will sometimes approve a tax with a "measure" whose elements exceed the limitations of the state constitution, if the "subject" of the tax is satisfactory.¹ By this means the courts have softened the harshness of extreme restrictions on taxation in the constitutions of several states. The federal courts, passing on the limitations of the Federal Constitution as applied to federal taxes, may similarly uphold taxes whose "measures" contravene a limitation (except that requiring uniformity) if the "subjects" are satisfactory.² When the question arises of applying limitations in the Federal Constitution to state and local taxes, however, the federal courts resort to a different rule. The recent trend of decisions indicates that the federal courts will hold invalid any state or local tax which transcends a limitation of the Federal Constitution in either its "subject" or "measure."³ Several exceptions exist to this well-established general rule. Among these may be noted here the proposition that in railroad and public utility cases, a state tax whose "subject" is property and whose "measure" extends to untouchable

¹ See, Thomas M. Cooley, "The Law of Taxation," fourth edition, Chicago, 1924, Vol. I, p. 299.

² *Flint v. Stone Tracy Co.*, 220 U. S. 107, may be cited as an illustration. This case sustained the federal excise of 1909 on corporations. The opinion states the "subject" of the tax to be "business done in a corporate capacity." This "subject" contravenes no constitutional limitation on the federal power of taxation. The opinion proceeds, "it is . . . well established by the decisions of this court that when the sovereign authority has exercised the right to tax a legitimate subject of taxation . . . , it is no objection that the measure of taxation is found in the income produced in part from property which, considered of itself, is non-taxable."

³ See the cases cited in Isaacs, "The Subject and Measure of Taxation." In particular, compare *Macallan Co. v. Massachusetts*, U. S. Sup. Ct., May 27, 1929, with *Flint v. Stone Tracy Co.*, cited above.

property or to activities in interstate commerce will be upheld.¹

These principles of "subject" and "measure" determine the constitutional background of turnover taxation in the United States. A federal general sales or turnover tax would have to satisfy the limitations of the Federal Constitution as to its "subject," but except for the uniformity requirement these restrictions might not be applied as to its "measure." State and local general sales or turnover taxes must be within the limitations of the Federal Constitution both as to "subject" and "measure." Their "subjects" would also have to satisfy the restrictions of the constitutions of their respective states; in some jurisdictions their "measures" might safely ignore these restrictions.

Aside from constitutional and statutory limitations, the possible "subjects" for federal, state and local turnover taxation are many.² A turnover tax may have for its "subject" property or some category of property, the privilege of doing business generally or under some particular form of business organization, the act of doing business, the privilege or act of production and manufacture, the act of sale or transfer generally or some aspect of this transaction. The choice of "subject" raises a double issue—on the one hand, the "subject" of a general sales or turnover tax is a factor in its scope; on the other hand, the choice of "subject" determines the validity of the tax under constitutional limitations.

Upon the "measure" of a tax depends its economic character. Therefore, for a tax to come within the category of general sales or turnover tax, its "measure" must be some aspect of sales value or value in sales transactions. As indicated above, the choice or wording of the "measure" of a particular turnover tax may not affect its constitutionality

¹ See, *St. Louis Southwestern Railway Co. v. Arkansas*, 235 U. S. 367, and cases cited in that opinion.

² This statement is made advisedly, in contradiction to the often-quoted dictum of the federal Supreme Court in *State Tax on Foreign Held Bonds*, 15 Wall. 319, that the only possible subjects are persons, property and business. While never specifically refuting this dictum, the courts, including the federal Supreme Court, have subsequently repeatedly referred to other subjects of taxation, such as "the privilege of doing business as a corporation" in corporation franchise or privilege tax cases and to the "act of transfer at death" in the Frick and other inheritance tax cases.

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if the particular tax is a federal tax being judged under limitations of the Federal Constitution, or, in some jurisdictions, if it is a state or local tax being judged under state constitutional limitations; where, however, a state or local turnover tax is being judged under limitations of the Federal Constitution, the choice and exact description of the "measure" of the tax is of highest importance.

CONSTITUTIONAL ASPECTS OF FEDERAL TURNOVER TAXATION

The Federal Constitution places five express or implied limitations on the power of the Federal Government to levy taxes. First, the Federal Government may not levy duties upon exports. Second, direct taxes must be apportioned among the states according to population and indirect taxes must be geographically uniform. Third, duties, imports and excises must be uniform throughout the United States. Fourth, the vague provision of the Fifth Amendment, that no person "shall be deprived of life, liberty or property without due process of law," is occasionally held to limit some exercises of the federal tax power. Fifth, there is the implied limitation that the Federal Government may not tax the property, agencies or instrumentalities of the state governments.

As indicated above, it is the "subjects," not the "measures," of federal taxes that are particularly subject to these limitations, except in the case of the uniformity requirement.

Property as the "Subject" of a Federal Turnover Tax

The Federal Government might levy a general sales or turnover tax on property or some aspect of property, the "measure" of the tax being the value of the sales made through the use of such property. The use of property, however, is severely restricted as the "subject" of a federal general sales or turnover tax by the second of the limitations stated above. To come within the limitation, the revenue to be derived from such a tax would have to be apportioned to each state according to its population, and an independent rate would have to be set for each state,

so adjusted to the taxable turnover of the state that the actual yield would coincide with the state's revenue quota on the basis of its population. Since the Federal Government has the power to levy a general sales or turnover tax on other "subjects," it would have no reason for resorting to this cumbersome system.

Production as the "Subject" of a Federal Turnover Tax

The act of production is a permissible "subject" for American federal turnover taxes, and no constitutional limitations restrict its use. As the sole "subject" of a turnover tax, it is, of course, available only when the turnover tax is of the type of a production tax. The federal Civil War general excise of 1862 was levied on the production of the taxed commodities rather than on business enterprise as such.¹ In this it was similar to the tobacco products excise which has remained an element of the federal internal revenue system to the present day. Similarly, the 3% tax on repairs and the 5% tax on subsidiary processes levied by the 1864 revenue law had as their "subjects" the acts of repair and the processes of polishing, painting and so forth, rather than the businesses of repairing or painting and polishing.¹ The second and third Smoot proposals in 1921, both providing a manufacturers' and producers' excise, would have levied a tax neither on the act of transfer at sale, nor on business enterprise as such.² Though popularly called "manufacturers' and producers' sales taxes," the proposed taxes would have been excises on the act of production, whether extractive or by manufacture.

It might be argued that a federal tax on the production of articles is a tax on the articles themselves, and hence is a direct tax under the first of the constitutional limitations stated in the introduction to this section. The contrary has been stated by the federal Supreme Court.³

Business as the "Subject" of a Federal Turnover Tax

The privilege of doing business, or the act of doing business, or any aspect of business, such as selling at retail, are

¹ See p. 189 of this volume.

² See pp. 192-193 of this volume.

³ *Patten v. Brady*, 184 U. S. 608.

all available as "subjects" of a federal general sales or turnover tax. The first two of these "subjects" would result in federal commodity transfer or general turnover taxes. The third would produce a federal retail sales tax.

It might be argued that the constitutional limitation forbidding the Federal Government to tax exports would affect the use of these "subjects," since a federal turnover tax based on the privilege or the act of doing business would apply to export houses, among other types of business enterprise. This limitation, however, has been held not to apply to federal taxes unless they rest directly on articles in the course of export transport or unless they are discriminatory.¹ A federal turnover tax with the privilege or the activity of business for a "subject" would not appear to breach either of these conditions.

The Act of Transfer at Sale as the "Subject" of a Federal Turnover Tax

The sales transaction may be viewed as a single and complete act, or it may be viewed as a series of related independent acts—the closing of the contract of sale, the transfer from seller to buyer of the title in the goods sold, the physical delivery by the seller to the buyer of the goods purchased, the making of payment by the buyer and the receipt of payment by the seller. A federal turnover tax might levy the tax upon the collective act of the sales transaction, as the first Smoot proposal in 1921 for a federal turnover tax would have done,² or it might take as its "subject" any one of the steps in the transaction. The choice would not be a matter of indifference, since certain constitutional limitations apply to some of these "subjects" and not to others.

If a federal turnover tax were based on the sales transaction in general, it might be necessary to exclude export sales from the operation of the tax, since a tax on this "subject" might be construed to be upon articles in the course of export transportation,³ and such a tax, as indicated above,⁴ contravenes the prohibition against federal taxation of exports.

¹ *Cooley, op. cit.*, Vol. I, p. 112.

² See p. 192 of this volume.

³ See, *Spaulding & Bros. v. Edwards*, 262 U. S. 66.

⁴ See p. 60 of this volume.

If the subject were the physical delivery of the goods sold by the seller to the buyer, the limitation would certainly apply. Were any of the other aspects of the sales transaction made the "subject" of a federal turnover tax, it might well be construed not to be such taxation of the actual exportation of goods as to bring it within the constitutional limitation. In view of the general tendency of countries levying national or federal turnover taxes to exempt export sales altogether,¹ this point is not of major importance.

A different constitutional question would arise if the transfer of title by the seller to the buyer or if the receipt of payment by the seller were made the "subject" of a federal turnover tax. In the case of imports into the United States, the situs of the transfer of title would generally be in the exporting country and payment would be received by sellers located abroad. The Federal Government would have no machinery to collect the tax from these sellers. If the Federal Government sought to collect the tax through domestic importers, this might be held to be such "deprivation of property without due process of law" as comes under the limitation of the Fifth Amendment. Most national and federal governments levying turnover taxes are anxious to extend these taxes to cover importation,² so that the disability of a federal turnover tax based on receipt of payments would be a serious restriction on its use. The disadvantageous effects of these discriminations, however, could be offset without difficulty by a special compensating import duty.

STATE AND LOCAL TURNOVER TAXES UNDER FEDERAL CONSTITUTIONAL LIMITATIONS

Within the limitations of their state constitutions, the taxing power of the state governments extends to the levy of general sales or turnover taxes. Also, their constitutions permitting, state legislatures can delegate the power to levy such taxes to municipalities, and one state, Missouri, has specifically done so. All such state or local turnover taxes, in addition to measuring up to the standards of constitutionality of the state constitutions under which they are

¹ See p. 135 of this volume.

² See pp. 130 ff. of this volume.

levied, must also conform with the limitations which the Federal Constitution places on the taxing powers of the states. The three federal constitutional limitations that bear upon the levy of state and local turnover taxes are: first, the limitation against extending the tax beyond the jurisdiction of the taxing state, derived from the "due process of law" clause of the Fourteenth Amendment; second, the limitation against taxing interstate commerce; and third, the limitation against taxing federal instrumentalities.

The "Subjects" of State and Local Turnover Taxation under Federal Constitutional Limitations

Property, the act of production, the act or privilege of doing business, and the sales transaction as a whole or some aspect of it, suggest themselves as possible "subjects" of state or local turnover taxes. The second and the third of this list of possible turnover tax "subjects" are embodied in the state and local turnover taxes now in force. The first and the fourth elements have not as yet had their constitutional possibilities tested by actual application.

Where railroads and public utilities are concerned, the federal courts have shown themselves very favorably inclined towards state or local taxes levied "in lieu of" property taxes. They have chosen to view such taxes as levied on property as a "subject" but "measured" by other yardsticks than the capital value of the property and, so considered, they have accorded such taxes all the freedom from federal constitutional restrictions enjoyed by ordinary property taxes, even to upholding them in cases where the "measures" of the taxes exceeded the restrictions of the Federal Constitution.¹

The courts have never been called upon to consider taxes levied "in lieu of" property taxes on any form of enterprise other than public utilities. It might appear logical that this principle could be freely extended to the taxation of business enterprises, that a state or local turnover tax could be levied with the property—the entire property or possibly only the personal property—of business concerns for a "subject" and with some element of sales value for its "measure."

¹ See, Isaacs, "Business and Property Taxes."

However, in taxing public utilities under this principle, fixed ratios of gross receipts to investment value have been established which permit a convenient equation of the burdens of the two measures of taxation. It is doubtful whether any such ratios could be fixed in the case of general business concerns that would meet the approval of the courts. Whether the courts would accept equation of the total yields of the two forms of taxation as satisfactory evidence that the general sales or turnover tax was levied "in lieu of" a property tax must remain an open question. If a state or local turnover tax levied in this manner should receive judicial approval, it might be freely used by the states as a substitute for their unenforceable personal property taxes.

The act of manufacturing or extractive production has never been definitely set forth in any state or local turnover tax statute as the "subject" of the tax. The Federal Supreme Court, however, has construed the St. Louis turnover tax as having "production" for its "subject" in so far as it applies to manufacturers, in order to save the tax from the interstate commerce limitation. In *American Manufacturing Co. v. St. Louis* (250 U. S. 464-465), the Court said of the St. Louis tax:

"The operation and effect of the taxing ordinance are to impose a legitimate burden upon the business of carrying on the manufacture of goods in the city; it produces no direct burden on commerce in the goods manufactured, whether domestic or interstate, and only the same kind of incidental and indirect effect as that which results from the payment of property taxes or any other and general contribution to the cost of government. Therefore, it does not amount to a regulation of interstate commerce. And, for like reasons, it has not the effect of imposing a tax upon property as business transactions . . . outside of the state . . . , and hence does not deprive . . . of property without due process of law."

The same position with regard to a drilling and distributing company under the West Virginia Business Occupation Tax was recently taken in *Hope Natural Gas Company v. Hall* (47 Sup. Ct. Rep. 639). These two cases link up with similar validation of taxation of sales to non-resident purchasers when the "subject" is construed as "production" under the Pennsylvania anthracite coal tax (*Heisler v.*

Thomas Colliery Co., 260 U. S. 245), under the Minnesota mining tax (*Oliver Iron Co. v. Lord*, 262 U. S. 172) and under the Louisiana severance tax (*Lacoste v. Department of Conservation*, 263 U. S. 545).

A state or local turnover tax based exclusively on production would necessarily limit the tax to manufacturers' sales. This would be contrary to the intent of the state and local turnover tax statutes as enacted. The effect of the American Manufacturing Company and Hope Natural Gas Company cases, therefore, has been to give state and local turnover taxes a double "subject." In so far as they relate to manufacturing and extractive production, the "subject" of the taxes is the act of production, and with a suitable "measure" the taxes can be extended to all sales, whether made to purchasers within or without the state. To the extent that these taxes apply to mercantile concerns, their "subject" is the act or privilege of doing business.

The more common "subject" of state or local general sales or turnover taxation is "business activity." This concept is often stated by American courts as a valid "subject" of taxation, but its definitions are loose and vague. The idea behind it is the old *quid pro quo* doctrine of taxation—the carrying on of business under the protection of the state is a privilege for which the state may demand a payment under the form of a tax. The American courts have never attempted to define the limits of "business activity," or to give the term a specific meaning. If a tax is laid upon or collected from business concerns of any broad category, and if it satisfies other constitutional requirements, it is held valid as a tax upon the "privilege" or the act of doing business. To satisfy federal constitutional limitations, however, "doing business" must be restricted to doing *intrastate* business *within the state*. If a business enterprise inherently or exclusively interstate in character is brought under the tax, then the tax contravenes the federal constitutional limitation against regulating interstate commerce. If business activities beyond the borders of the state are brought under the tax, then the state government is seeking to tax beyond its jurisdiction, without "due process of law," which is also contrary to the limitations of the Federal Constitu-

tion. It is an open question whether, if a manufacturing or merchandizing concern maintained its warehouses in a state other than that levying the turnover tax, closed its sales contracts in this other state and made its deliveries therefrom, the state levying a turnover tax on "business activity" could extend its tax to cover these sales. The state of West Virginia does so extend its turnover tax, but there has never been judicial determination whether or not this action is constitutional.

Of the American state turnover taxes, only the 1921 Gross Sales Tax of West Virginia made "sales transactions" the "subject" of the tax, but this occurred rather by the inadvertent wording of the law than by the deliberate intent of the legislators. With this exception, "sales transactions" has never been utilized as the "subject" of a state or local turnover tax, but there are no inherent obstacles to such use. Probably, in the case of the turnover taxes of the American states, tradition has been the most important factor in excluding the use of the sales transaction as the "subject" of state or local taxation. Until very recent years, the state governments were chary about levying excises on transfers or acts, there being an undefined feeling that this subject of taxation was the exclusive province of the Federal Government.

A state or local turnover tax levied with sales transactions as the "subject" would have to be limited to sales made within the taxing state or locality; otherwise, the state or local government would be attempting to extend its tax "without due process of law" beyond its jurisdiction. This limitation would afford a broad loophole to manufacturers and producers. They could locate their warehouses and sales branches in neighboring states, and so escape the tax, while carrying on other operations in the taxing jurisdiction. It is difficult to see how a state or local government could prevent this type of avoidance if the turnover tax levied on manufacturers and producers had "sales transactions" as its "subject." If it proved advisable to base a turnover tax on merchants and occupations other than manufacturing and extractive production with "sales transactions" as a "subject," it would be imperative to split the

tax and levy a separate turnover tax on manufacturers and extractive producers with "production" as the "subject."

A turnover tax levied on merchants, with the "sales transaction" as an entire act for a "subject," would probably contravene the interstate commerce limitation to the extent that it was applied to the sales of resident merchants to non-resident purchasers. These sales would be clearly transactions in interstate commerce. However, if the tax statutes were carefully worded so that one particular aspect or step of the sales transaction—the transfer of title from seller to purchaser—were specifically made the "subject" of the tax, it is possible that the interstate commerce limitation would not apply to the levy of the tax on this category of sales. The transfer of property title, by the law of sales in practically all states, including those which have modeled their sales laws on the Uniform Sales Act, is a matter of intent, but is usually presumed to occur on delivery of the goods by the seller directly to a buyer, or, when shipped by a common carrier, on delivery to the common carrier, which is considered the agent or bailee of the purchaser.¹ In a few instances transfer of property title occurs before delivery, and under certain special forms of F. O. B. sales contracts it occurs on delivery of the goods by the common carrier to the purchaser. Transfer of title is a specific legal act, and, except where expressed intent is clearly to the contrary and in the special F. O. B. sales noted above, it is interpreted to occur within, and is subject to the authority of, the state in which the seller is located. A state or local turnover tax levied on delivery of title might induce sellers to provide specifically in their sales contract for transfer of title outside the taxing jurisdiction, with a view to avoiding the tax. Transfer of title is determinable by state laws, however, and the taxing state could provide in its tax statute that transfer of title for purposes of the tax should occur within its jurisdiction when the seller is located or operates there. No present state turnover taxes have embodied this "subject" and the courts have not passed on it. If accepted by

¹ Samuel Williston, "The Law Governing Sales of Goods at Common Law and under the Uniform Sales Act," second edition, New York, 1924, Vol. I, Sections 278, 278a.

the courts, it might be valid for a turnover tax on the sales of all merchants located or operating within the state.

Use of "transfer of title" as the "subject" of a state or local turnover tax would permit of no safeguard against avoidance of the tax by merchants and manufacturers who located warehouses in neighboring states, closed their sales contracts in these other states and made deliveries from these warehouses. For the state levying the turnover tax based on "transfer of title" to extend its tax to these transactions would appear clearly to bring the tax under the federal constitutional limitation against levying taxes beyond the taxing jurisdiction.

The "Measures" of State and Local Turnover Taxation under Federal Constitutional Limitations

It may be taken as established that generally the "measures" of state and local turnover taxes must conform to the limitations of the Federal Constitution as strictly as the "subjects" of such taxes.¹ Considerable care must therefore be taken to so define the "measure" of a state or local turnover tax that it will not run afoul of the federal constitutional limitations against taxing interstate commerce and against taxing "without due process of law"; otherwise the tax will be crippled in its application. The "measures" of state and local turnover taxation to be considered are: (1) sales value of goods produced, (2) sales value of goods entering into a sales transaction, (3) sales value of goods held in stock for sale, and (4) sales value of goods at transfer of title.

The "measure" of "sales value of goods produced" would have logical application only if the "subject" of a state or local turnover tax were the act of production itself. The United States Supreme Court indicated in *American Manufacturing Co. v. St. Louis* (250 U. S. 459) and related cases,² that it did not consider extractive or manufacturing production used as either the "subject" or the "measure" of a state or local turnover tax to be an element of interstate commerce. Moreover, so definite is the concept of situs in

¹ See p. 59 of this volume.

² See quotation and citations on p. 65 of this volume.

the case of such activity that there is no question of a state's jurisdiction in taxing production and in employing production as an element of the "measure" of the tax.

The second "measure" for state or local turnover taxes—the sales value of goods entering into a sales transaction—is not free from constitutional difficulties. In *Crew Levick Co. v. Commonwealth of Pennsylvania* (245 U. S. 292), the United States Supreme Court held that if the sales transaction as an entire act enters as an element of the "measure" of a tax, it contravenes the interstate commerce limitation. The Crew Levick Company case dealt with the taxation of the sales of resident merchants to non-resident purchasers under the Pennsylvania Mercantile License Tax. The Court held:

"The tax . . . bears no semblance of a property tax, or a franchise tax in the proper sense; nor is it an occupation tax except as it is imposed upon the very carrying on of the business of exporting merchandise. It operates to lay a direct burden upon every transaction in commerce, by withholding, for the use of the State, a part of every dollar received in such transactions. That it applies to internal as well as foreign commerce cannot save it."

By subsequently refusing to review a case (*State ex rel. International Shoe Co. v. Chapman*, 300 S. W. 1076), appealed from the Missouri Supreme Court, the United States Supreme Court in *Chapman v. International Shoe Co.* (276 U. S. 635) impliedly reaffirmed its position in the Crew Levick Company case, since the state court had relied upon that case in its decision. Use of this second "measure" of a state or local turnover tax, therefore, would negative the attempt to extend the tax to the sales of resident producers or merchants to non-resident purchasers. If the tax were divided, as in the case of the St. Louis tax, and the tax on extractive and manufacturing producers were levied on the act of production and "measured" by the sale value of the goods produced, it would be permissible to tax the sales of resident producers to non-resident purchasers, but taxation of the sales of resident merchants to non-resident purchasers would still be banned.

It would appear that the third "measure" of a state or local turnover tax—the sales value of goods held in stock for sale—does not contravene the federal constitutional limita-

tions against taxing interstate commerce, if it is combined with a valid "subject" such as business activity or some valid aspect of the sales transaction itself. The federal courts have never passed on such a "measure" for a state or local turnover tax, but in *Doscher v. Query* (21F [2nd] 521) a district court in 1927 dealt, among other issues, with the taxation of the interstate sales of merchants under a South Carolina occupation tax on tobacco merchants, where the tax was collected by attaching stamps to tobacco commodities as soon as they came into the stock of the tobacco merchants. The Court held:

"Just as the commerce clause will not protect property from taxation after its interstate journey has ended and it has come to rest and become a part of the general mass of property within the state, neither will that clause protect from taxation property that is still at rest and a part of such general mass of property, even though it be intended for export or shipment in interstate commerce, if the movement in foreign or interstate commerce be not actually commenced. And this is true, notwithstanding that the goods have been transported in interstate commerce to the place where they are sought to be taxed, and are intended for shipment into other states, if they have reached the destination of their first journey and are being held by the owner for disposition in the ordinary course of business, and the stoppage be not a mere temporary delay in transportation."

What position the Supreme Court would take on the issue as presented in *Doscher v. Query* can not be predetermined. In the absence of decision by the Supreme Court, the opinion of the district court may be held to indicate a possible statement of the law on the issue as presented.

One shortcoming of this "measure" may be noted. As indicated in the preceding section,¹ a possible method of avoiding a state or local turnover tax with "transfer of title" as subject would be to close the contract of sale in, and make deliveries from, warehouses located in other jurisdictions than that levying the turnover tax. Use of "sales value of goods held in stock for sale" as a "measure" would permit of no check to this method of avoidance, since the stock of goods held in the warehouse would clearly be outside the jurisdiction of the taxing government.

The "measure" of "sales value of goods at transfer of

¹ See p. 67 of this volume.

title" has never been subjected to judicial determination, so that its constitutionality is a matter of conjecture. The same arguments that sustain "transfer of title" as a valid "subject" of state or local turnover taxation¹ are in favor of this element as the "measure" of the tax. As a "measure," it would likewise open a way to avoidance of the tax through arranging for transfer of title in jurisdictions other than that levying the turnover tax.

Status of the Federal Instrumentalities Limitation

No case has arisen on a state turnover tax in its application to sales made to the Federal Government. A recent decision of the United States Supreme Court on the validity of the Mississippi gasoline tax, levied as a privilege tax on gasoline dealers and "measured" by their sales, when such sales were made to the Federal Government, would indicate that such sales can not be included in the "measure" of a state occupation or privilege tax. In *Panhandle Oil Co. v. Mississippi* (48 Sup. Ct. Rep. 451), the Court held that a state "may not levy any tax upon transactions by which the United States secures the things desired for its governmental purposes." The decision was five to four, however, and the issue may not be considered finally closed.

STATE AND LOCAL TURNOVER TAXES UNDER STATE CONSTITUTIONAL LIMITATIONS

State courts tend to validate state and local taxes under the limitations of their state constitutions so long as the "subjects" of the taxes conform to these limitations. In their provisions relating to taxation, the state constitutions range between the absolute freedom of the New York constitution to the detailed specification of the Louisiana constitution. Apart from special constitutional provisions that might hinder the levy of state turnover taxes in particular states, two limitations common to most of the state constitutions may be considered with respect to their bearing on the levy of state turnover taxes. These two state constitutional limitations are the requirement of uniformity and equality in

¹ See p. 68 of this volume.

state and local taxation, and the requirement of taxation according to value. The levy of a general sales or turnover tax by a local government would depend, of course, on the existence of a state enabling statute.

The Equality and Uniformity Limitation

The state constitutional limitation that state or local taxes must be "equal" or "uniform" applies only to property taxation. If the "subject" of a state or local turnover tax were the act of production, the act or privilege of doing business, or some aspect of the sales transaction itself, the limitation would not apply. It would arise as a pertinent factor only if the "subject" of the tax were some category of property.

This limitation does not exist in all states. The constitutions of New York, Connecticut and South Dakota, for example, do not impose this restriction. In Rhode Island and Iowa the provision is so broad that it has little binding effect. In most of the states, however, this limitation must be taken into consideration. According to Judge Cooley, "The requirement of equality and uniformity of taxation relates to the rate of taxation, the valuation for taxation, territorial equality. . . . The rate of taxation must be the same, at least as to the same class. . . . The valuation must be based on the same percentage, at least as to the same class of property. . . . On the other hand, the requirement does not apply to the method of levying, assessing and collecting taxes."¹

This limitation has received differing constructions in different jurisdictions. Where a liberal view has been taken, state taxes on particular kinds of property "measured" by net income, by capitalization of corporation dividends and by gross receipts have been upheld. In these jurisdictions, a tax on the personal property of business concerns "measured" by sales or turnover might be upheld by the state courts. Where state courts take a stricter view of this limitation, there is a strong probability that a state or local turnover tax with some category of property for a "subject" would not be upheld. The attitude taken by the state

¹ Cooley, *op. cit.*, Vol. I, p. 260.

courts towards a state or local turnover tax levied as a property tax with respect to state constitutional limitations would not, of course, have any bearing upon the constitutionality of such a tax under the limitations of the Federal Constitution.

The Limitation of Taxation According to Value

A few state constitutions provide that when property is taxed, the "measure" of the tax must be the value of the property. This limitation expressly forbids the levy of a state or local turnover tax in the form of a property tax, suggested in this chapter as a possibility. An example of this application is found in Nebraska, where a tax on corporation franchises as property, "measured" by the gross receipts of the corporations, was declared invalid.¹

THE LEGAL "SUBJECTS" AND THE SCOPE OF TURNOVER TAXATION

The legislative choice of "subject" for a turnover tax statute, or its judicial construction, is a major factor in determining the scope of the tax.

Scope of Turnover Taxes on Sales Transactions

If the act of sale and purchase in general, or if some feature of this act, such as the closing of the sales contract, or delivery of the items sold, or payment by the purchaser, be made the "subject" of a turnover tax, it may be given the broadest possible scope. Unless such transactions are specifically excluded, the tax extends to incidental sales by individuals or firms (sales not made in the regular course of business), to sales of immovable property, and, if the concept of "sales transaction" be broadly construed, to all business and professional services. It makes no difference in the scope of a turnover tax, though it may be of great constitutional importance, whether its "subject" be sales transactions in general or some particular feature or stage of the transaction.

A turnover tax based on sales transactions in general, or on

¹ *Western Union Telegraph Co. v. City of Omaha*, 73 Neb. 527.

some particular step in the sales transaction, or even on such a category of sales transactions as business sales, is necessarily a multiple-turnover tax, since a single commodity or article may enter such a transaction several times in the course of its progress from raw material to the purchase by its consumer. If the "subject" of a turnover tax is limited to such a category of sales transactions that no article or commodity can be subjected to the tax more than once—for example, the first manufacturer's sale or the final manufacturer's sale, or the retail sale—the tax becomes a single-turnover tax, with markedly different economic and administrative effects from a multiple-turnover tax.

Scope of Turnover Taxes on Business Activity

Many sales transactions occur outside the scope of business activity. Consequently, if the privilege of engaging in business activity, or the act of making a business sale, be established as the "subject" of a general sales or turnover tax, the scope of such a tax must necessarily be narrower than that of a tax based on general sales transactions. All incidental sales not made by individuals or concerns in the regular course of their business activity must be excluded. If "business activity" be strictly construed to cover only activity conducted with a view to profit making, then the sales of cooperative associations and of charitable associations might also be outside the scope of the tax, whereas these transactions, unless specifically exempted, would come under a turnover tax with sales transactions for its "subject." The performance of professional services might also be construed to be outside the scope of "business activity."

Of course, any limitation of the "subject" as to the form of business activity brought under the tax, would still further narrow its scope. Thus the "subject" of the Connecticut Merchants' and Manufacturers' Tax is "business activity of unincorporated concerns." Sales made by corporations in Connecticut, by no means an inconsiderable proportion of Connecticut sales, do not come under the tax. It is questionable whether a sales or transfer tax with its scope limited in this sharp fashion properly comes under the heading of a general sales or turnover tax.

If the limitation of the "subject" is upon the category rather than the form of business activity, as, for example, a privilege tax on manufacturing or, as in Pennsylvania, a privilege tax on merchandizing, the universal and uniform application of the tax, essential to the concept of a general sales or turnover tax, is retained, since the tax applies to all commodities or articles alike. Such limitations upon the taxable categories of business enterprise necessarily narrow the scope of the tax. If the limitation is on a category of business enterprise constituting a single link in the chain of industrial and commercial activity, such as production of raw materials or manufacture and completion of articles, or their retail sale, the resulting tax will be a single-turnover instead of the usual multiple-turnover tax.

Scope of Turnover Taxes on Property

A state general sales or turnover tax might possibly be levied with property, or some aspect of property, as its "subject." The scope of such a turnover tax would be practically identical with that of a turnover tax based on the privilege or act of doing business; both taxes would exclude incidental sales by individuals.

THE OCCURRENCE OF TAX LIABILITY

The choice of the "subject" and "measure" of a turnover tax determines the time when such liability accrues and the situs of the tax—the place where such liability occurs. The first issue, that of the time when the taxpayer's liability accrues, is of practical importance since on it depends whether his tax payments are due in advance, coincidental with, or subsequent to, his receipts from the sale. On the second issue, that of situs of the tax, depend the possibility of double taxation and the validity of the tax under the federal constitutional limitation against the levy of taxes beyond the jurisdiction of the taxing government.

When Does Tax Liability Accrue?

The "measure" that produces the earliest accrual of tax liability is the "sales value of goods in the act of produc-

tion." At the latest, the tax is due on the completion of the industrial process engaged in by the taxed concern, though the individual articles produced may not be sold until long after, or may even be destroyed before sale. Were the tax to be collected when due, a radical modification would be imposed on the accounting systems of the taxed concerns and they would be compelled to pay taxes before they had received the income from which to pay such taxes. Therefore, in setting up the fiction of an excise on manufacture and production "measured" by the sales value of such manufacture, in *American Manufacturing Company v. St. Louis* (250 U. S. 459) and *Hope Natural Gas Company v. Hall* (47 Sup. Ct. Rep. 639) in order to validate the taxation of interstate sales by manufacturers, the federal courts have also set up the allied fiction of deferment of payment until sales are made.

The "measure" set up in *Doscher v. Query* (21 F. [2nd] 521), that of "value of goods held in stock for sale," would cause a turnover tax to accrue one stage later in the industrial process, but still considerably in advance of receipt of the income from which to pay the tax. Here, also, it might be desirable to defer the payment of the tax to a time later than when it accrues.

The common "measure" of "value of goods entering into a sales transaction" and the suggested "measure" of "value of goods at transfer of property title" both result in an accrual of the tax coincidental with the setting up of the sales in the account books of the seller. Since these accounts are the practical means of calculating the tax liability of the taxpayer, the sense of the tax law, if not its wording or its "measure," is that the tax is determined by these accounts. In accounting procedure the value of goods sold is usually set up in the books as "accrued" at the time of transfer, though payment may not be made until later. If a tax were collected by stamps attached to invoices and bills of sale, as in the Belgian and Italian turnover taxes, the tax would actually be paid in advance of the receipt of cash for the sale. Where the tax is assessed periodically on the gross receipts from sales as shown in the accounts of the seller, which is the customary procedure, this lag between

accrual of tax liability and payment for the sale is of little account, since during the period between tax payments the taxpayer has enjoyed the proceeds from sales on which he has not yet made tax payments.

Installment or "deferred payment" sales present a special case. The seller may not receive full payment on such sales for months or years after the sale has been made. To compel full tax payments on such sales would work a real hardship on many concerns. The federal income tax recognizes the reporting of such sales on a cash instead of an accrual basis. A turnover tax should make a similar exception.

Double Taxation

Double turnover taxation—the repeated taxation of transactions or articles identical from an economic point of view—could occur if states levying turnover taxes based their taxes on different "subjects" and, also, if they used different "measures." If one state used the "act of production" for the "subject" of a tax on manufacturers and producers, and a second state used "sales transactions" as the "subject" for a tax on all sales made within the state, a manufacturing concern operating in the first state and maintaining a sales branch and warehouses in the second state would have to pay two taxes on what was, from an economic point of view, a single transaction. Another case of double taxation might arise if one state levied a turnover tax based on production, business activity or sales transactions "measured" by value of goods in stock for sale or by value of goods at transfer of title, and a second state levied a retail sales tax based on value of purchased goods in stock, thereby reaching purchases from non-resident sellers—provided, of course, this latter type of tax received judicial sanction.

The limited use of general sales or turnover taxes by the states at present does not give rise to any problems of double taxation. Enactment of turnover tax statutes by further states might do so. A solution would have to be sought in reciprocity, as in the case of the state inheritance taxes, or in some other form of compromise.

CONCLUSIONS

Since the general sales tax is one that may be levied by either the Federal Government or the state governments, it is necessary to consider its constitutionality under two headings.

Federal Turnover Taxation

The constitutional restrictions placed on the Federal Government's powers of taxation are not such as would prevent its levying a general sales or turnover tax. It could make such a levy as a tax on the privilege or act of doing business, or more narrowly as a tax on the act of manufacturing and extractive production, or finally, as a tax, in the nature of an excise, on sales transactions in general or on some particular aspect of the sales transaction. There is also the possibility that it might be able to levy a general sales or turnover tax as a direct tax on the property of business concerns, "measured" by the value of their sales. The constitutionality of this last mentioned exercise of the federal tax power would be doubtful, and the administrative difficulties it would involve would make it inadvisable, particularly when other simpler methods are possible.

Since taxing the act of exportation under a federal general sales or turnover tax would be inexpedient for economic reasons, the constitutional obstacles to extending a federal turnover tax to the act of exportation are not of practical importance. There would also be constitutional difficulties in the way of bringing the act of importation under a federal general sales or turnover tax, but these could be avoided by taxing imports under a separate, supplementary import turnover duty collected on the occasion of the entry of the goods into the country.

State or Local Turnover Taxation

The constitutions of most of the states present no bar to the levy of state turnover taxes, or to the levy of local turnover taxes where authorized by the state legislature. State and local turnover taxes must of course be consistent with the express or implied limitations of the Federal Constitu-

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tion; these restrict somewhat the possibilities of state and local turnover taxation.

A state or local government may levy a turnover tax based on the privilege or act of production without conflicting with any federal constitutional limitation. Such a tax may be extended to all goods produced within the taxing jurisdiction, irrespective of whether they are subsequently sold to customers within or outside the state. If a state or local turnover tax is levied upon "the privilege or act of doing business," it may not be extended to sales made to customers located in other states; otherwise it is unconstitutional as interfering with interstate commerce. The states and cities at present levying turnover taxes on business enterprise avoid this difficulty by levying their taxes on manufacturers and extractive enterprises as taxes on the act of production, and by limiting their taxes on merchants to intrastate sales.

It is possible that the sales of merchants to customers located outside the state might be brought under a turnover tax based on "the act or privilege of doing business" if, instead of "measuring" the tax by the value of the sales themselves, it were "measured" by the value of the goods held in stock. It is also possible that if a state or local turnover tax statute were so worded that the tax was levied on the "transfer of title" of the goods sold, and the amount of the tax was "measured" by the value of the goods at this transfer of title, it might be held constitutional. No state or local government has yet levied a general sales or turnover tax in either of these forms, and their constitutionality has not undergone the test of the courts.

CHAPTER III

ADMINISTRATIVE ASPECTS OF GENERAL SALES OR TURNOVER TAXATION

A MAJOR argument, frequently proposed, in favor of general sales or turnover taxes is that they are easy for the taxpayer to understand and to comply with, and hence are relatively simple and inexpensive to administer. The tax is based on gross receipts from sales, a measure that involves the simplest and most elementary of accounts for a manufacturer or dealer, which even the smallest dealer is likely to keep, if only as a basis for obtaining insurance. Returns on the tax and its payment may be made at convenient short intervals, so that the tax on the taxpayers' books takes on the character of a running expense and does not possess the irksomeness of a heavy tax paid at annual periods.

This reasoning is sound for certain forms of general sales or turnover taxes. It does not apply to others. A discrimination introduced for social or legal reasons may completely change the administrative character of the tax. In Chapter I it was shown that there were no general economic principles applicable to all turnover taxes; the circumstances and details of the individual tax determine its economic and social character. Similarly, the administrative possibilities of general sales or turnover taxation must be studied with regard to the special forms and discriminations of the tax rather than as generalizations upon this type of taxation as a whole.

TAXES COLLECTED ON THE INDIVIDUAL SALES TRANSACTION

The basic manner of collecting the commodity transfer taxes of Italy and Belgium is by revenue stamps attached to invoices or bills of sale, or by remittances accompanying duplicates of each invoice or bill of sale sent immediately to the revenue collector. Marked administrative advantages attach to this method of collecting the tax upon each indi-

vidual sales transaction. There are, however, counterbalancing disadvantages.

Advantages

The collection of taxes on articles or on the sales of articles by the affixation of stamps either to the articles themselves or to the evidences of their title or transfer, with suitable penalties for failure to affix such stamps, is perhaps the simplest and most effective method of tax collection. When the stamp is attached to the article itself, the evidence of payment or non-payment of the tax is visible throughout the commercial life of the article. If the purchase as well as the sale of the unstamped article is penalized, conspiracy to evade the tax is minimized. The risk of detection is too great to be compensated by the small gain represented by the amount of the tax.

When the stamp is to be attached, not to the article itself, but to the paper evidence of its title or transfer, the risk of evasion is somewhat increased. It is usually provided in such cases, in the United States at least, that a non-stamped invoice or bill of sale can not be sued on or entered as evidence in court. In this case, also, the risk of loss may be considered too great to balance the gain from evasion of the tax.

Wherever the attachment and cancellation of a stamp is possible, a stamp tax is practically self-enforcing. No supervision of the accounts of individual taxpayers is necessary. The government receives its revenue through the sale of stamps, and the expenses of tax collection are reduced to negligible proportions. Such simplicity of tax collection and administration is not to be found in the Italian system of stamping or attaching remittances to duplicates of the original invoices or bills of sale. The taxpayer must keep the full set of duplicates as cancelled by the tax collection office. These provide a check against his books if his accounts are investigated at any time, but the system is not self-enforcing. It does eliminate, however, the necessity of special accounting, either by the taxpayer or by the tax administration.

Disadvantages

The major disadvantage of basing the collection of a gen-

eral sales or turnover tax on the individual sales transaction is that it is not applicable to all types of sales transactions. It collapses miserably in retail sales of articles of small value.¹ The local grocer or dry goods dealer does not make out a bill of sale for each sale nor can he conveniently affix stamps to all the items he sells. Moreover, there is little probability or possibility of uncovering evasions actually effected. The Italian commodity transfer tax is not weakened by this difficulty since retail sales to consumers are not subject to the tax. The exclusion of retail sales from the tax, however, sharply reduces its revenue possibilities. The Belgian turnover tax includes retail sales in its scope but exempts small sales. It is generally believed that evasion of the Belgium tax by retailers is widespread.

Another disadvantage of a general sales or turnover tax collected on the individual sales transaction, from the sellers' point of view, is the necessity of paying the tax in advance of payment for the sale. If the tax is paid quarterly or monthly, the seller is enabled to collect a part, at least, of his payments and to hold or use the money so received before he pays the tax on these sales. If the tax is collected through stamps or remittances on the occasion of each sales transaction, the seller must advance the tax before touching any of the sales money out of which the tax is paid. Moreover, when goods are subsequently returned to the seller and all or part of the sales price is refunded, or when the buyer defaults on his payments, the seller is put to a bothersome procedure to obtain refunds, whereas when the tax is based on periodic accountings, such returned goods or defaulted payments can usually be set off against the taxable turnover of the period.

ADMINISTRATIVE ASPECTS OF GENERAL TURNOVER AND COMMODITY TRANSFER TAXES

Uniformity is a valuable administrative asset for any tax. Exemptions, limitations and discriminations complicate the drafting of a return by the taxpayer, and open up channels

¹ Edgard Allix and Marcel Lecerclé, "La taxe sur le chiffre d'affaires," Paris, 1927, pp. 8-9.

of evasion. The tax administration has the added labor of checking more complicated returns and of circumventing broader possibilities of evasion.

In their pure forms, the general turnover tax and the commodity transfer tax embody the desirable attribute of uniformity more fully than do other forms of turnover taxation. All producers and dealers must report their sales and be taxed thereon; no producer or dealer can escape the tax by claiming that he belongs to an exempt class. Under a commodity transfer tax, it is true, there is some overlapping between the producers or dealers in taxable commodities and the creators of non-taxable services, but the dividing line here is less confused than in most other spheres of economic endeavor.

Three general forms of discrimination may be incorporated into a general turnover or a commodity transfer tax. The first type of discrimination, the exemption of small producers and dealers, or provision for their taxation on simple arbitrary bases, is of administrative character. The second type of discrimination, rate classification between classes of producers and dealers, and the third, discriminations between commodities and services either directly or through rate consolidation on the Austrian plan, are economic in character. Consideration of the first form of discrimination is reserved for a later part of this chapter. Analysis of the administrative aspects of the second and third types of discrimination follows.

Rate Classification by Types of Business Enterprise

Classification of producers or dealers and the application of special rates to different classes does not add to, or reduce, the number of returns to be made out by taxpayers or handled by the administration, unless, of course, the tax law goes to the length of exempting outright some class or classes of producers or dealers, as does the Pennsylvania Mercantile License Tax. It does not add any complexity to the returns to be made out by taxpayers, nor does it add to the labor of checking these returns by the administration. The administrative disadvantages of rate classifications are that they require the tax administration and the courts to draw hairline

boundaries between such overlapping activities as manufacturing and merchandizing and between wholesale merchandizing and retail merchandizing. Taxpayers on the borderlines are induced to classify themselves in the lower-taxed group, a tendency that requires additional alertness and investigation on the part of the administration. Out of the conflicts of judgment so arising between taxpayers and the administration grows litigation expensive to both taxpayers and to the government.

The most fertile field for dispute exists in cases where a concern purchases raw material or semi-finished produce, advances it an economic stage by some process of manufacture or technique, and resells it. In Pennsylvania, where manufacture is not taxed on its turnover, whereas merchandizing, wholesale and retail, comes under the Mercantile License Tax, this problem is particularly acute. Innumerable cases have been referred to the courts. Caught on debatable ground, the courts have failed to be consistent. A tanner has been held to be a manufacturer, and not subject to the Mercantile License Tax; a leather cutter has been held a merchant, and subject to the tax. A plumber is a manufacturer and his turnover is not taxable; a paperhanger is a dealer and taxable. A butcher is a manufacturer if he slaughters the animals whose meat he sells; otherwise he is a dealer. The failure of the courts to lay down consistent distinctions has maintained and even augmented the original uncertainty of the law.

Wholesale and retail merchandizing also overlap. Wholesale dealers often conduct retail departments or at least make occasional retail sales. Since retail sales are taxed more heavily than wholesale sales where there is a difference in the rates on the two types of merchandizing, to permit wholesalers to be taxed at wholesale rates on their retail sales would discriminate unfairly against the retailers who must compete with them. To tax the total turnover of wholesalers making incidental retail sales at the higher retail rate, however, would lay an excessive tax burden on such wholesalers and place them at a competitive disadvantage with other wholesalers who make no retail sales. The solution is to require wholesalers to report any retail sales separately and to tax only the latter

at the higher retail rate. Since wholesalers who conduct an incidental or a regular retail business habitually keep separate records for the two sets of sales as a matter of business practice, the requirement of separate returns for the two classes of sales imposes no special burden of accounting.

Discriminations between Commodities and Services

The most important discriminations between commodities embodied in general turnover or in commodity transfer taxes is the exemption of foodstuffs with a view to diminishing the burden of these taxes on the poorer classes. This horizontal discrimination does not present any problem of classifying taxpayers, as do rate classifications by types of business enterprise. Many taxpayers, however, find that their turnovers must be classified, one part taxable and the other non-taxable. In general this imposes no heavy accounting labor upon them. It does, however, open an avenue of evasion. The dealer who would hesitate to conceal any part of his turnover if it were entirely taxable, might not hesitate to report some of the taxable items among the non-taxable, knowing that such evasion would be more difficult to detect than outright concealment.

If, instead of an outright exemption or a single low rate for the selected commodity or service, a general turnover tax or a commodity transfer tax embodies several special rates, as occurs in the Polish turnover tax, the possibilities of evasion are multiplied and the administrative labor of preventing such evasion is correspondingly increased.

Rate Consolidation

The principle of consolidating a general turnover tax or a commodity transfer tax, as applied in Austria, Czechoslovakia and Belgium, has already been described.¹ Such consolidation, particularly when carried to the extreme lengths of the Austrian law, results in horizontal discrimination of the most complex kind. On the one hand, most commodities can be sold free of any turnover tax at one or another stage of their economic progress, since the tax on them has been consolidated and attached to one particular stage

¹ See pp. 26-28 of this volume.

or process. On the other hand, there exists a complicated schedule of consolidated rates, in the Austrian tax running into hundreds of items, applying to minute classes of commodities and paid by one or another producer or dealer as indicated in the schedule. A producer or dealer handling several lines of commodities must classify his sales accounts into as many independent systems. Some commodities are exempt, while on the others he must calculate turnover taxes at minutely fractioned rates.

At first glance, a schedule of hundreds of independent rates would appear to impose an impossible accounting burden on producers and dealers. As a matter of practice, each producer need keep track of only the rates applying to the items he handles. Moreover, to the extent that producers and dealers specialize in different lines of commodities, the administration need check them only on their special lines. Even so, for many individual producers and dealers the consolidated tax must produce an unwonted accounting complexity. Moreover, with numerous groups of tax-free commodities on his list, a producer must constantly face a strong temptation to include some of his taxable sales under the tax-free total. Borderline cases constantly arise which the taxpayer decides in his own favor. It is beyond administrative possibility to remedy all the semi-innocent mistakes thus arising, let alone to check outright fraudulent evasion.

Rate consolidation places still a further responsibility on the administrators of a turnover tax. The determination of the consolidated rates is generally made the task of administrative officials, not of the legislature. In Austria, the ideal is to determine a consolidated rate for each commodity equivalent to the total rate of a pyramided turnover tax, taking into consideration the normal number of turnovers at the average price on each turnover for each commodity. If the circumstances of the production of any commodity alter in the course of years, if the number of economic steps in its production and distribution increase or decrease, a change should be made in the consolidated rate. The officials charged with rate determination are under constant pressure to revise downward the consolidated rate on this or that article. In sacrificing rate uniformity in turnover taxation,

the Austrian legislators have made the consolidated rate schedule of the tax a battleground for special interests.

ADMINISTRATIVE ASPECTS OF THE PRODUCTION TAX

The production tax is a type of single-turnover tax—that is, each commodity is to be taxed once, and once only, in the course of its production. If a tax is laid generally on production and manufacture measured by gross sales or turnover, so that all manufacturers and producers pay it on the totals of their output, irrespective of the fact that several of them may be engaged upon successive stages of the manufacture of the same commodities, such a tax is not a production tax in the strict sense of the term but a species of commodity transfer tax embodying a discrimination between manufacture and merchandizing.

Reduced Administrative Scope

The administrative advantage claimed for the production tax is that tax liability is restricted to a narrow group of producers, most of whom have well developed systems of accounting. Thousands upon thousands of dealers, retail and wholesale, would not be called upon to make returns or pay any part of the tax. Many manufacturers, moreover, would be excluded from the tax if they produced articles taxed at earlier or later stages of their manufacturing progress. This restriction on the number of taxpayers under a production tax would save extensive labor of accounting and reporting by thousands of business men. It would reduce the checking activities of the tax administration to a fraction of what would be necessary for a general turnover tax or for a commodity transfer tax.¹

The broad reduction of administrative scope accomplished by the production tax does not altogether eliminate the small concern having only ill-kept accounts. Many articles are the result of handicraft manufacture. To require tax reports from such producers imposes on some of them a new problem and labor of accounting; the review of these reports covering

¹ Johannes Popitz, "Allgemeine Verbrauchsteuer," in "Handbuch der Finanzwissenschaft," Vol. II, p. 193.

small amounts of taxes is a relatively expensive procedure for the administration.

Prevention of Multiple Taxation of Commodities

To tax each commodity once, and once only, in the course of its process of manufacture, may be accomplished in two ways: by pinning the tax for each individual commodity on some particular stage in the manufacture of that commodity, or by provision for rebates where items already taxed are subject to further stages of manufacture.

The first method, that of pinning the tax to some particular stage of manufacture for each commodity, raises numerous difficulties. The consolidation of a general turnover tax or of a commodity transfer tax, as is done in the Austrian turnover tax, raises the same problem. The Germans, after a study of the Austrian system, decided that although the isolation of particular processes as foci of tax liability had proved practicable in Austria, where industrial development was still somewhat backward, it could not work in more industrialized Germany.¹ Under the Austrian system, however, tax liability in many cases centers on distributive instead of industrial processes; this solution would be contrary to the intent and principle of a production tax. The Austrians, moreover, discovered many articles on which the turnover tax could not be consolidated because of the complexity of their manufacturing and distributive history, and in these cases they permitted the turnover tax to be levied at its basic rate on each turnover. Such pyramiding or repeated taxation would also be contrary to the intent of the production tax.

The possibility of levying a production tax by pinning the tax for individual commodities to specific manufacturers must be excluded from consideration. The alternative is to levy the tax on all manufacturers, but to allow rebates in cases where a tax has already been paid or will subsequently be paid on any commodity. This was the method suggested for the United States federal production tax proposed in 1921, and is the method followed in the administration of the Canadian Manufacturers' Excise.

¹ Luther, "Denkschrift," p. 6.

The administrative procedure that would have been necessitated had the federal production taxes proposed for the United States in 1921 become law, was never developed beyond the outline stage. It was suggested that Treasury regulations would provide for exemption in the case of partly manufactured goods which would not be suitable for consumption purposes. In the case of goods suitable either for immediate consumption or for further manufacture, the manufacturer would be freed of the tax if, at the time of sale, he obtained a statement from the purchaser that the goods sold were intended for further manufacture.

The advocates of these taxes ignored their glaring administrative weaknesses. For one thing, the system of affidavits of proposed further manufacture would break down completely in cases where manufacturers sold goods suitable either for direct consumption or for further manufacture to dealers who might sell either directly to consumers or to other manufacturers. In such cases there would be double taxation; the first manufacturer would be taxed on his output, and the manufacturer who bought the semi-finished goods from a dealer and reworked them would be taxed on his output also.¹

Moreover, the Treasury would have had an initial heavy task of isolating those manufactured articles which were incapable of consumption without further reworking, in order to provide for their exemption. Subsequently, it would be faced with the impossible problem of checking the affidavits of re-manufacture, in order to prevent sellers and purchasers from entering into collusion to evade the tax. Evasion under this system would probably have been widespread and it would have been difficult, if not impossible, to have prevented it with any degree of success.

The Canadian Government, which put a production tax into practice, found it necessary to develop a more complex system of administrative procedure. All manufacturers and all dealers who make more than half of their sales to manufacturers are licensed and listed by the Ministry of Finance, with appropriate penalties for failure to take out a license. The production tax applies to both manufacturers and

¹ See, *Congressional Record*, 67th Cong., 1st Sess., p. 7246.

licensed dealers. No tax is paid by members of these two groups on their sales to other manufacturers or licensed dealers. In general, this system avoids multiple taxation of commodities. The only possibility of such multiple taxation occurs in the case of dealers who make some sales, but less than half, to manufacturers, and who consequently do not take out licenses. A manufacturer who sells partly finished goods to such a dealer must pay a tax on their sale, since the dealer is not licensed. The dealer resells them to another manufacturer, paying no tax. The second manufacturer, after completing the manufacture of the articles, must pay a second tax on them. Such cases of double taxation, however, constitute a small fraction of the total taxable turnover.

A production tax on the Canadian model is administratively practicable, but at the cost of uniformity and simplicity. In the case of the Canadian tax, the resulting accounting complexity is augmented by a broad list of commodity exemptions and by the requirement of monthly returns. One Canadian taxpayer complains:

"Only those thoroughly conversant with approved commercial bookkeeping practice, can appreciate the additional functions necessary in any organization to carry innumerable sales tax items from cost or billing clerk's entries, through the various accounting stages of properly recorded tax-included or tax-additional invoices, to the visible and segregated monthly aggregates acceptable to departmental inspections. Supplementary legislation and continued departmental bulletins have extended sales tax exemptions—vertically, from licensed wholesaler through to consumers by means of Government funds—horizontally, from manufacturers for reprocessing to manufacturers of ships and farming implements, and to the milling industry—proportionally, from labor in repairs and installed contracts to freight in laid down cost, and in consequence, non-taxed sales invoices must be daily extracted from sales compilations, rebate claims must be prepared, suspense accounts established awaiting judicial decisions or settlement of issues between Dominion and Provincial Governments, all of which must certainly be reflected in the cost of commodity production. Sales taxes being payable monthly in respect to commodities invoiced, whether or not the manufacturer has received payment, create manufacturers unwilling bankers for the Government during the period between remittance to it and receipt from the purchaser, and in the event of non-collection of accounts, they become penalized sureties. Even the required monthly declara-

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tions upon oath, of the correctness of filed returns, adds its element of expense, especially when Income Tax regulations are satisfied with the use of a simple certificate."¹

Complication of accounting procedure for the taxpayer means complication of checking procedure for the administration. To avoid evasion by taxpaying manufacturers and dealers who report tax-exempt sales to other licensed manufacturers or dealers when in fact the sales were made to consumers or unlicensed dealers and were therefore taxable, the administration must compare the reports of tax-exempt sales by each taxpayer with the reports of purchases by other licensed manufacturers and dealers.

Another possibility of eliminating double taxation of commodities under a production tax would be to call upon all manufacturers to pay a tax on their gross sales, but to allow them a rebate of all taxes paid in the earlier turnovers of the articles they produced. This would necessitate billing the tax separately from the sales price in all instruments of transfer. Moreover, not only the tax paid by the immediate manufacturer but all taxes paid by his predecessors in the production of the article sold would have to be listed, thus adding considerably to each manufacturer's accounting procedure. Moreover, dealers who bought partly finished goods from one manufacturer and resold them to another would also have to bill such taxes through both purchase and sale. To prevent evasion by listing in rebate claims taxes that were never actually paid by predecessors, the administration would have to compare purchases and sales and would have to call upon dealers for reports of their sales to manufacturers, even though the dealers paid no taxes on any of their sales. The labor of administering a production tax of this type would be just as heavy as in the case of the Canadian tax.

ADMINISTRATIVE ASPECTS OF THE RETAIL SALES TAX

Like the production tax, the retail sales tax seeks to tax all commodities once, and once only. It has the advantage in that the transaction which gives rise to tax liability, the re-

¹ Canadian Tax Conference, "Proceedings of the Second Annual Convention," 1924, p. 12.

tail sale to the ultimate consumer, is easier of perception than the broader process of manufacture, which is the basis for the production tax. It nevertheless presents serious administrative problems. Chief among these are the problems of determining who should be retail sales taxpayers, the number of returns involved, and the question of retail sales made to business concerns.

Retail Sales Taxpayers

Under a retail sales tax, all retail dealers would pay a tax on their turnovers. Wholesalers and manufacturers, however, also make sales at retail, in some cases as an established branch of their business, in other cases only incidentally. To leave these retail sales outside the scope of a retail sales tax would, as has already been pointed out, work a discrimination against retail dealers, since the retail sales of manufacturers and wholesalers oftentimes compete directly with the sales of retail dealers. All wholesalers and manufacturers making retail sales, or at least those who sell at retail as an established practice in their business, must be brought within the scope of tax liability.

To require wholesalers and manufacturers who sell at retail to make returns on their retail sales would not impose an irksome burden upon them. As a matter of business practice, such firms usually keep separate accounts for their wholesale and retail sales. Their retail turnovers would be taken directly from their books as they stand. The tax administration would, of course, have an additional number of returns to supervise, but this checking and supervision would not be arduous, since the reporting wholesalers and manufacturers, as a class, keep well-ordered accounts—much better than those kept by the mass of retailers who would comprise the bulk of the taxpayers.

If a retail sales tax extended to the performance of services as well as to the sale of commodities, there would be no problem of arbitrarily delimiting the class of taxpayers. A retail sales tax confined to commodity sales, however, would create a troublesome group of borderline cases. Does a druggist compounding a prescription, or a restaurant serving cooked and prepared foods, or a printer working on indi-

vidual orders, sell a commodity or a service? If all such borderline cases were excluded outright from the scope of a retail sales tax, they would enjoy a beneficial discrimination as against commodities with which they were in direct competition. If it were sought to include all cases where doubt might arise, no line could be readily drawn short of the inclusion of all services. Probably as practicable a compromise as any would be to include all cases involving the sale of a tangible commodity whose original ingredients or materials were supplied by the seller. Such a compromise would not eliminate all discrimination between competitors—the custom tailor making a suit from materials supplied by his customer would be favored as against the custom tailor making a suit from material chosen by the customer from the tailor's stock. Such discrimination would be inconsiderable, however, and the basis of the tax itself would have the important advantage of definiteness.

The Number of Returns

The most serious administrative disadvantage of a retail sales tax is the large number of returns and the small amount of tax collections involved in many of the returns. A general turnover tax or a commodity transfer tax would result in even more returns, since they would cover manufacturers and dealers not included in the scope of a retail sales tax, but the average tax per return would be higher for these taxes because of the larger turnovers of manufacturers and wholesale dealers who would also come under it. A production tax would show still better results, since it would be limited to manufacturers and some wholesalers, with a high average individual turnover. A census survey of nine American cities¹ in 1925 and 1926 showed 17,404 manufacturers located in these cities as against 92,385 retail dealers.² The average annual turnover per manufacturer in this group was \$317,347; the average annual turnover per retailer was \$45,018.

¹ Atlanta, Ga.; Baltimore, Md.; Chicago, Ill.; Denver, Colo.; Kansas City, Mo.; Providence, R. I.; San Francisco, Cal.; Seattle, Wash.; Syracuse, N. Y.

² U. S. Bureau of the Census, "Census of Manufactures, 1925"; Chamber of Commerce of the United States, "Retail and Wholesale Trade of Eleven Cities," Washington, 1928.

Moreover, the class of retail dealers contains a large proportion of individuals who are unaccustomed to keeping accounts, even for their own business purposes. Reporting for a retail sales tax would impose an unfamiliar and unwelcome labor upon such dealers, though the requirement of adequate records, from a business point of view, would not be an unmixed evil. However, too much should not be made of this difficulty. Though such dealers may keep only rudimentary accounts, they usually have some record of turnover, since this figure is generally asked for as a basis for extending credit or granting insurance.

The difficulty of handling a large number of returns and that of checking ill-kept accounts would be greatly reduced by provision for the exemption of small turnover or by fixing a flat tax for all turnover under a given minimum. These possibilities are considered independently below.¹

Retail Sales to Business Concerns

It would not be contrary to the principles of retail sales taxation to view business concerns as ultimate consumers of equipment and office supplies, and to tax their purchases of such items. Larger firms, however, buy their supplies and equipment at wholesale, and the attempt to bring such sales under a retail sales tax would lead to endless confusion and open paths to evasion. As a practical matter, then, such wholesale purchases by business concerns can not be subjected to a retail sales tax; as a matter of justice, the retail purchases of smaller firms should not be taxed.

One method of exempting retail sales to business concerns would be to permit the seller to list such sales independently, and to report them free of taxation. This would involve multiplicity of accounts and destroy the essential attribute of uniformity. Moreover, it would open paths to evasion. It would be an impossible task to check a retailer's report of sales to business concerns, and he would be encouraged to list taxable sales to individual consumers under the head of non-taxable sales to business concerns. The alternative is to tax all sales made at retail, whether the purchasers are individuals or business concerns. The business concerns,

¹ See pp. 99, 101 of this volume.

however, should be permitted to deduct the amount of retail sales tax charged in prices to them from taxes payable by them to the same taxing jurisdiction. The suggestion that a tax paid out under one tax law should be allowed as a credit to the tax payable under another tax law is not altogether novel. The personal property tax credit under the present income taxes of California, Washington and Oregon is an example. The record of retail sales taxes so deductible would exist in the file of the business concern's bills from retailers.

THE PROBLEM OF THE SMALL TAXPAYER

The cost of checking, tabulating and filing a return that covers only a couple of dollars of taxes is out of all proportion to the revenue obtained. Many such small returns increase the relative cost of the collection of the tax. All forms of general sales or turnover tax except the production tax involve a high proportion of small returns. Good practice requires some method of eliminating these.

Distribution of Taxpayers by Amount of Turnover Tax Paid

Statistics on the distribution of turnover taxpayers by the amounts of their turnover—or, what is equivalent, by the amounts of turnover tax paid—are available only for Germany and for France. For Germany the figures cover 1924, and for France they cover 1922 and 1923. The figures on German taxpayers are presented in Table 1 and those on French taxpayers in Table 2.

Of the 4,929,243 taxpayers who filed returns for the German general turnover tax in 1924, 83.6% reported less than R. M. 10,000 turnover and 72.7% reported less than R. M. 5,000 turnover. The tax paid by those reporting under R. M. 10,000 turnover was 11.3% of the total tax paid. Only 6.7% of the total tax was paid by those reporting turnovers of R. M. 5,000 or less. Elimination of returns for taxpayers reporting turnovers of R. M. 5,000 or less would have reduced the number of returns by nearly three-quarters and would have reduced the yield of the tax little more than one-sixteenth.

The proportions involved varied considerably for the dif-

TABLE 1: PERCENTAGE DISTRIBUTION OF TAXPAYERS AND TURNOVERS UNDER THE GERMAN TURNOVER TAX, BY AMOUNT OF TURNOVER, 1924
(Source: Statistik des Deutschen Reichs, Vol. 353, pp. 30-31)

Amount of Turnover		All Taxable Activity		Agriculture		Industry		Commerce		Skilled Professions, Public Employees, the Military and the Clergy		Medical and Hygienic Institutions	
		Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over
Under	R.M. 1,000	33.1	1.0	44.5	7.2	21.3	0.3	22.8	0.5	47.9	2.3	27.7	2.9
R.M. 1,001 to	2,000	19.0	1.7	23.9	10.8	16.3	0.6	12.5	0.8	15.7	2.5	21.2	6.3
2,001 to	5,000	20.6	4.0	20.4	20.1	21.6	1.8	19.5	2.8	13.9	4.9	28.8	18.6
5,001 to	10,000	10.9	4.6	7.1	15.5	13.7	2.5	15.3	4.8	8.3	6.6	12.7	17.7
10,001 to	20,000	7.2	6.1	2.6	11.0	10.7	3.9	12.7	7.9	6.4	10.1	5.7	15.8
20,001 to	50,000	5.2	9.6	1.0	9.5	8.7	7.0	9.9	13.4	4.8	16.6	3.0	17.9
50,001 to	100,000	1.9	7.9	0.3	6.8	3.4	6.0	3.7	11.1	1.6	12.6	0.6	8.3
100,001 to	200,000	1.0	8.6	0.1	6.6	1.9	6.9	1.9	11.6	0.8	11.7	0.2	5.0
200,001 to	500,000	0.7	12.0	0.1	6.3	1.4	11.1	1.2	15.2	0.4	13.8	0.1	3.9
500,001 to	1,000,000	0.2	8.8	1	2.4	0.5	9.5	0.3	9.5	0.1	9.0	1	2.2
1,000,001 to	5,000,000	0.2	17.7	1	2.6	0.4	22.5	0.2	14.6	0.1	9.9	1	1.4
5,000,001 and over		1	18.0	1	1.2	0.1	27.9	1	7.8	..	..	..	..
Total	.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

¹ Less than 0.05%.

however, should be permitted to deduct the amount of retail sales tax charged in prices to them from taxes payable by them to the same taxing jurisdiction. The suggestion that a tax paid out under one tax law should be allowed as a credit to the tax payable under another tax law is not altogether novel. The personal property tax credit under the present income taxes of California, Washington and Oregon is an example. The record of retail sales taxes so deductible would exist in the file of the business concern's bills from retailers.

THE PROBLEM OF THE SMALL TAXPAYER

The cost of checking, tabulating and filing a return that covers only a couple of dollars of taxes is out of all proportion to the revenue obtained. Many such small returns increase the relative cost of the collection of the tax. All forms of general sales or turnover tax except the production tax involve a high proportion of small returns. Good practice requires some method of eliminating these.

Distribution of Taxpayers by Amount of Turnover Tax Paid

Statistics on the distribution of turnover taxpayers by the amounts of their turnover—or, what is equivalent, by the amounts of turnover tax paid—are available only for Germany and for France. For Germany the figures cover 1924, and for France they cover 1922 and 1923. The figures on German taxpayers are presented in Table 1 and those on French taxpayers in Table 2.

Of the 4,929,243 taxpayers who filed returns for the German general turnover tax in 1924, 83.6% reported less than R. M. 10,000 turnover and 72.7% reported less than R. M. 5,000 turnover. The tax paid by those reporting under R. M. 10,000 turnover was 11.3% of the total tax paid. Only 6.7% of the total tax was paid by those reporting turnovers of R. M. 5,000 or less. Elimination of returns for taxpayers reporting turnovers of R. M. 5,000 or less would have reduced the number of returns by nearly three-quarters and would have reduced the yield of the tax little more than one-sixteenth.

The proportions involved varied considerably for the dif-

TABLE 1: PERCENTAGE DISTRIBUTION OF TAXPAYERS AND TURNS OVERS UNDER THE GERMAN TURNOVER TAX, BY AMOUNT OF TURNOVER, 1924

(Source: Statistik des Deutschen Reichs, Vol. 353, pp. 30-31)

Amount of Turnover	All Taxable Activity		Agriculture		Industry		Commerce		Skilled Professions, Public Employees, the Military and the Clergy		Medical and Hygienic Institutions	
	Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over	Tax-payers	Turn-over
Under R.M. 1,000	33.1	1.0	44.5	7.2	21.3	0.3	22.8	0.5	47.9	2.3	27.7	2.9
R.M. 1,001 to 2,000	19.0	1.7	23.9	10.8	16.3	0.6	12.5	0.8	15.7	2.5	21.2	6.3
2,001 to 5,000	20.6	4.0	20.4	20.1	21.6	1.8	19.5	2.8	13.9	4.9	28.8	18.6
5,001 to 10,000	10.9	4.6	7.1	15.5	13.7	2.5	15.3	4.8	8.3	6.6	12.7	17.7
10,001 to 20,000	7.2	6.1	2.6	11.0	10.7	3.9	12.7	7.9	6.4	10.1	5.7	15.8
20,001 to 50,000	5.3	9.6	1.0	9.5	8.7	7.0	9.9	13.4	4.8	16.6	3.0	17.9
50,001 to 100,000	1.9	7.9	0.3	6.8	3.4	6.0	3.7	11.1	1.6	12.6	0.6	8.3
100,001 to 200,000	1.0	8.6	0.1	6.6	1.9	6.9	1.9	11.6	0.8	11.7	0.2	5.0
200,001 to 500,000	0.7	12.0	0.1	6.3	1.4	11.1	1.2	15.2	0.4	13.8	0.1	3.9
500,001 to 1,000,000	0.2	8.8	1	2.4	0.5	9.5	0.3	9.5	0.1	9.0	1	2.2
1,000,001 to 5,000,000	0.2	17.7	1	2.6	0.4	22.5	0.2	14.6	0.1	9.9	1	1.4
5,000,001 and over	1	18.0	1	1.2	0.1	27.9	1	7.8	..	..	..	..
Total.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

¹ Less than 0.05%.

TABLE 2: DISTRIBUTION OF TAXPAYERS AND TAXES PAID UNDER THE FRENCH TURNOVER TAX, BY AMOUNT OF TURNOVER, 1922 AND 1923

(Source: Franz Scholz, "Grundrissz des französischen Steuerrechts," pp. 176, 177)

Amount of Turnover	1922				1923			
	Taxpayers	Percentage Distribution	Tax Paid (In thousands)	Percentage Distribution	Taxpayers	Percentage Distribution	Tax Paid (In thousands)	Percentage Distribution
Under fr. 5,460	533,806	32.2	fr. 18,014	0.9	368,238	30.4	fr. 16,267	1.4
fr. 5,460 to 10,920	276,592	16.1	25,855	1.2	216,267	17.8	20,198	1.7
10,920 to 54,600	519,442	30.2	170,995	8.0	387,030	32.0	119,446	10.1
54,600 to 109,200	165,275	9.6	145,575	6.8	114,753	9.4	99,706	8.5
109,200 to 145,500	176,233	10.2	604,849	28.5	32,404	2.8	46,416	3.9
145,500 to 181,800					22,826	1.9	56,454	4.8
181,800 to 363,500					31,939	2.7	96,824	8.2
363,500 to 1,092,000					24,622	2.1	172,367	14.6
1,092,000 to 13,650,000	27,741	1.6	655,678	30.9	10,624	0.9	351,071	30.0
13,650,000 and over	1,650	0.1	504,251	23.7	419	¹	198,052	16.8
Total	1,700,739	100.0	fr. 2,125,217	100.0	1,209,122	100.0	fr. 1,176,801	100.0

¹ Less than 0.05%.

ferent economic classes of taxpayers. Of agriculturalists filing returns in 1924, 88.8% had turnovers under R. M. 5,000, but this group paid 38.1% of the R. M. 7,320.8 millions collected from the class. This sum collected from German agriculturalists, however, represented only 8.9% of the total German turnover tax collections for 1924. Of the manufacturers and producers reporting, 59.2% reported turnovers under R. M. 5,000 and accounted for 2.7% of the tax on their group. Merchants and dealers with turnovers under R. M. 5,000 represented 54.8% of the total number and paid 4.1% of the total tax of the group.

There is no correspondence between the figures for the distribution of French taxpayers and their turnover, shown in Table 2, and the figures for German taxpayers in Table 1. For one thing, the amounts by which the French turnovers are distributed have no relation to the amounts determining classifications for the German tax; moreover, the value of the franc varied considerably during 1922 and 1923. Still, the French figures show a situation closely analogous to the German. In both 1922 and 1923 there was a heavy concentration of taxpayers in the lower turnover classes, with a very small proportion of the total tax collected from these small taxpayers. In both years, slightly less than half of the French taxpayers had turnovers under fr. 10,920 (between \$650 and \$800 at the exchange rates of those years) and this group paid between 2% and 3% of the total turnover tax.

The relative concentration of small-turnover taxpayers differs according to the type of turnover tax employed. A production tax involves only slight concentration of small-turnover taxpayers because the many small-turnover retailers do not come under the tax. The proportion is higher for a general turnover tax than for a commodity transfer tax, since a larger proportion of services than of commodities is produced by small-turnover concerns. A retail sales tax would show the heaviest concentration of small-turnover taxpayers, because the large-turnover manufacturers and wholesalers would not come under the tax.

Exemption of Small Turnovers

The simplest method of eliminating the many returns from

small-turnover taxpayers is to incorporate a minimum exemption into the tax. If the German and French statistics provide any guidance, a \$2,000 exemption would eliminate a good half of the returns without seriously affecting the yield of the tax. An exemption as high as \$5,000 might be justified for administrative reasons in the United States, but such a high exemption would make serious inroads on both the basis and the yield of the tax. There can be no justification or excuse for a \$10,000 exemption, such as is embodied in the West Virginia Business Occupation Tax.

Exemptions in turnover taxation should be of the conditional type—that is, exemption of the entire turnover should be allowed up to the exempted amount, but turnovers exceeding this exemption amount should be taxable in total. A conditional exemption of this character works highly inequitably in the case of a non-shifted tax where the ability of the taxpayer is a consideration, but general sales or turnover taxes are usually shifted. The one administrative disadvantage of a conditional exemption is that concerns with turnovers slightly in excess of the prescribed exemption are tempted to report themselves as within the exempted group, a method of evasion not easily checked. Against this disadvantage of the conditional exemption system, however, must be set the considerable loss of revenue involved in a continuing exemption allowed irrespective of the amount of the total turnover. The \$10,000 exemption in the West Virginia tax is of the continuing type, and is to be condemned for its character as well as its amount.

Minimum exemptions may succeed in eliminating the flood of returns from small-turnover taxpayers, but they result in discrimination between taxpayers. A dealer or a manufacturer with a large turnover may sell the same article as a competitor with a turnover under the exemption minimum. The large-turnover dealer or manufacturer must pay a tax which is not levied on his small competitor. If he includes the tax in his prices, he runs the risk of losing some of his market to his competitor; if he does not charge the tax in his prices, it reduces his profits. If the exemption limit is sufficiently low, the large-turnover taxpayer can afford to ignore the competition of exempted dealers and manufac-

turers. If it is high, however, as in the West Virginia Business Occupation Tax, the business done by exempted dealers and manufacturers may be sufficiently large to be a controlling element on the market, and their tax-free competition may be a serious concern to the taxed concerns.

Minimum Taxes

In place of exempting all concerns with turnovers under the prescribed minimum, such concerns might be taxed a flat amount. The amount of this minimum tax would depend upon the rate of the general sales or turnover tax and upon the prescribed minimum. In the case of a 1% tax rate and a prescribed annual minimum of \$2,000, a flat tax of from \$10 to \$15 would be indicated for those with annual turnovers under the \$2,000 minimum. Such a flat tax would discriminate somewhat against manufacturers or dealers with turnovers under \$1,000 or \$1,500 and it would discriminate in favor of those concerns with turnovers between these amounts and \$2,000. The individual advantage or disadvantage, however, would never be very great nor would a serious disturbing factor be introduced into the competitive market, as in the case of an outright exemption of a large competitively-important business class.

A flat minimum tax of this type has certain positive administrative advantages. All concerns are called upon to pay the tax, so that all must report to the tax administration, thus reducing the opportunity for evasion through non-reporting on a claim of exemption, which is always a more difficult fraud to check than is misreporting. The return accompanying the flat tax may be in the form of an affidavit to the effect that the firm's turnover is less than the prescribed minimum. Such an affidavit, if fraudulent, raises the possibility of legal penalties for perjury as well as administrative penalties for misstatement, and the probabilities of evasion along these lines are considerably reduced.

The Compounded Tax

Another method of administering a turnover tax applying to producers or dealers with small turnovers, many of whom keep imperfect accounts, would be to permit them to make rough

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estimates of their turnovers as being within prescribed limits, and to set fixed tax amounts for these limits. For example, turnovers under \$10,000 may be grouped into ten classes graduated by \$1,000 amounts. With a 1% rate for the tax, an annual turnover estimated as under \$1,000 would pay \$10, an annual turnover estimated as between \$1,000 and \$2,000 would be taxed \$20, and so forth up to a \$100 tax on annual turnovers estimated between \$9,000 and \$10,000. Taxpayers keeping accurate books would be permitted to report their turnovers as shown by their books to obtain any benefit in the tax that would result therefrom.

Taxpayers estimating their turnovers for the compounded tax would be required to report such items as rent paid, amount of insurance carried and number of full-time and part-time assistants employed, as a check on their estimates of turnover. These items would require a minimum of accounting on the part of the taxpayer, and would be susceptible of easy check by the administration.

Most of the European turnover tax laws make such or similar allowance for small-turnover taxpayers. It is usually provided that the taxpayer and the administration shall come to an agreement as to the average annual turnover of a small concern, on which the taxpayer pays his tax without further necessity of accounting. In France, a system of compromise payments has been in force since 1924. Since January 1, 1928, producers and dealers in commodities with annual turnovers under fr. 300,000 and creators of consumption services with annual turnovers under fr. 40,000 have been permitted to compromise their turnover taxes on the basis of the turnovers of preceding years, and pay lump sums quarterly instead of reporting on their exact monthly turnovers. In Poland, this method of estimating the turnovers of small enterprises on presumptive bases is practiced to such an extent that the tax paid under this system is more than double the tax paid on reports of specific turnovers.

PERIOD OF PAYMENT

From the government's point of view, it is a decided advantage to have tax receipts flow into the treasury smoothly

and evenly throughout the year. Periodic collections of taxes result in an awkward rhythm of activity for the tax collection departments. Since governmental expenditures tend to spread themselves through the fiscal year, periodic receipts of taxes put the government to the necessity of adjusting receipts to expenditures, either by building up balances during periods of tax inflow or by borrowing during the interims. The shorter the periodicity of tax collections, the less the government is called upon to "even out" tax receipts.

It is within the power of a taxing government to set collection dates of any periodicity for any tax. For many taxes, however, frequent payment would involve installment payment of a tax accruing at longer intervals. Capital value taxes must be assessed as of a given date, and annual intervals are the only practicable ones. Net income taxes must be based on an accounting balance, and for many types of business enterprise this is practicable only once a year. Turnover, or gross sales, however, requires no extensive accounting for determination. It is possible for a general sales or turnover tax to be assessed as well as collected for any period convenient to the taxing government. In the case of income taxes and capital value taxes, assessed once a year, it is customary to spread the payment of the tax in installments over the year following the assessment. This practice is not followed in general sales or turnover taxation because of the convenience of adjusting periods of payment to periods of assessment.

Taxes on the Individual Sales Transaction

Italy and Belgium, as has been indicated,¹ base their turnover taxes on the individual sales transaction. Through the purchase of stamps or by remittances, the turnover taxes of these countries are assessed day by day and the revenue from these taxes flows steadily into their treasuries. The only irregularity in the receipt of income from a turnover tax of this form is that resulting from seasonal or incidental fluctuations in business activity. Table 3, showing receipts from the Italian turnover tax tabulated at monthly intervals, indicates the even spreading of the receipts from this tax over the year.

¹ See p. 81 of this study.

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TABLE 3: MONTHLY RECEIPTS FROM THE ITALIAN TURNOVER TAX, 1923 TO 1928

(Source: Conti Riassuntivi del Tesoro)

Month	1923	1924	1925	1926	1927	1928
<i>Amount (in thousands)</i>						
January..	lire 16,717	lire 47,319	lire 67,179	lire 66,456	lire 58,343	lire 48,003
February..	15,339	44,192	62,131	69,170	59,011	54,753
March....	12,019	53,157	70,145	83,841	67,341	57,366
April.....	37,162	55,508	71,892	84,821	69,651	55,373
May.....	40,503	56,105	71,090	74,077	58,439	57,736
June.....	44,616	57,904	68,108	71,857	51,757	55,037
July.....	42,971	50,427	71,187	73,837	49,906	56,875
August....	43,392	51,268	62,990	67,337	48,728	51,802
September..	42,781	58,306	76,745	71,809	52,470	58,286
October...	51,208	75,434	92,672	76,201	61,094	68,963
November	46,807	58,621	69,233	64,645	49,914	57,592
December	40,421	57,576	66,360	64,853	52,313	57,045
Total...	lire 433,936	lire 665,817	lire 849,732	lire 868,904	lire 678,967	lire 678,831

<i>Percentage Distribution</i>						
January..	3.8	7.1	7.9	7.6	8.6	7.1
February..	3.5	6.6	7.3	8.0	8.7	8.1
March....	2.8	8.0	8.3	9.6	9.9	8.4
April.....	8.6	8.3	8.5	9.8	10.3	8.1
May.....	9.3	8.4	8.4	8.5	8.6	8.5
June.....	10.3	8.7	8.0	8.3	7.6	8.1
July.....	9.9	7.6	8.4	8.5	7.3	8.4
August....	10.0	7.7	7.4	7.7	7.2	7.6
September..	9.9	8.8	9.0	8.3	7.7	8.6
October...	11.8	11.3	10.9	8.8	9.0	10.2
November	10.8	8.8	8.1	7.4	7.4	8.5
December	9.3	8.7	7.8	7.5	7.7	8.4
Total...	100.0	100.0	100.0	100.0	100.0	100.0

Monthly Returns

The most frequent practicable period for demanding turnover tax returns is monthly. This is the period for payment of turnover taxes in France, Germany (from 1923 to 1927), Austria and Canada.

The necessity of reporting monthly returns works a particular hardship on small manufacturers and dealers who may be able to make a fair estimate of their annual turnovers but find it impossible to determine their gross sales on a monthly basis. Moreover, monthly payments from such small-turnover taxpayers would be individually minute, yet they would involve as much labor of collection and checking as large

returns. As described previously,¹ the problem of the small turnover taxpayer is frequently solved by permitting him to estimate his annual turnover in round numbers. In those countries which provide for monthly collections of their turnover taxes, the small turnover taxpayer is allowed to pay his annual tax over longer intervals, usually quarterly. In France, the tax payments made on this quarterly basis have constituted only a small fraction of the total; as shown in Table 4, they effect only a slight modification of the monthly distribution of payments. In Germany, the privilege of quarterly payments is accorded to all business concerns to whom monthly calculations of turnover would prove an inconvenience; as shown in Table 5, over one-half of the German turnover tax in 1927 and 1928 was collected in the four quarterly-payment months.

Quarterly Returns

Quarterly returns possess the advantage of being more convenient for many business concerns. They also involve only one-third as much labor of collection and supervision as do monthly returns. Most of the countries levying general sales or turnover taxes collect them on a quarterly basis. Of the American state turnover taxes, that of West Virginia is collected quarterly.

Quarterly returns of turnover taxes do not yield the even flow of collections that characterizes monthly returns; this disadvantage is offset, however, by the greater administrative convenience to taxpayers and to the tax collection agencies. Seasonal variations in business activity impart a noticeable but not a serious rhythm to quarterly collections. This rhythm is indicated in Table 6, which shows the collection for the West Virginia turnover tax swelling in the first quarter of each calendar year and receding in the third.

Annual Returns

All the American state and local turnover taxes, except those of West Virginia, are assessed and collected annually. There is no significant advantage either to the government or to the taxpayer in annual returns and collections—in fact,

¹ See p. 102 of this volume.

TABLE 4: MONTHLY RECEIPTS FROM THE FRENCH TURNOVER TAXES, 1921 TO 1928

(Source: *Bulletin de Statistique et de Legislation Comparée*)

Month	1921	1922	1923	1924	1925	1926	1927	1928
<i>Amount (in thousands)</i>								
January.....	fr. 184,739	fr. 193,027	fr. 232,107	fr. 304,283	fr. 430,615	fr. 499,330	fr. 855,961	fr. 820,771
February.....	153,289	165,903	203,299	290,172	340,938	452,673	708,698	731,218
March.....	148,684	171,485	219,555	304,532	334,874	397,391	605,112	648,914
April.....	159,017	183,975	249,919	347,521 ¹	397,058	537,697 ¹	768,518	808,327
May.....	147,960	182,445	241,014	345,385	392,393	513,407	774,167	789,157
June.....	147,899	191,556	243,385	326,464	356,222	551,107	645,146	707,974
July.....	148,523	199,034	259,197	381,016	376,417	692,148	794,428	859,906
August.....	147,420	188,585	257,750	334,409	369,485	726,404	696,999	780,921
September.....	157,944	187,564	259,400	323,102	349,721	704,047	619,529	682,175
October.....	168,599	209,330	294,171	429,836	377,141	857,557	777,426	885,599
November.....	172,759	211,953	291,325	370,869	426,634	824,707	712,823	801,044
December.....	173,738	215,847	279,632	352,378	403,550	732,062	670,848	759,223
Total.....	fr. 1,910,571	fr. 2,300,704	fr. 3,030,754	fr. 4,109,967	fr. 4,555,048	fr. 7,488,530	fr. 8,629,655	fr. 9,285,273
<i>Percentage Distribution</i>								
January.....	9.7	8.4	7.7	7.4	9.4	6.7	9.9	8.9
February.....	8.0	7.2	6.7	7.1	7.5	6.0	8.2	7.9
March.....	7.8	7.5	7.2	7.4	7.3	5.3	7.0	7.0
April.....	8.3	8.0	8.2	8.4	8.7	7.2	8.9	8.7
May.....	7.8	7.9	8.0	8.4	8.6	6.9	9.0	8.5
June.....	7.7	8.3	8.0	7.9	7.8	7.4	7.5	7.6
July.....	7.8	8.6	8.6	9.3	8.3	9.2	9.2	9.3
August.....	7.7	8.2	8.5	8.1	8.1	9.7	8.1	8.4
September.....	8.3	8.2	8.6	7.9	7.7	9.4	7.2	7.4
October.....	8.8	9.1	9.7	10.5	8.3	11.4	9.0	9.5
November.....	9.0	9.2	9.6	9.0	9.4	11.0	8.2	8.6
December.....	9.1	9.4	9.2	8.6	8.9	9.8	7.8	8.2
Total.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

¹ Rate increase effective.

TABLE 5: MONTHLY RECEIPTS FROM THE GERMAN TURNOVER TAXES, 1921 TO 1928

(Source: *Wirtschaft und Statistik*)

Month	1921		1922		1923		1924	1925	1926	1927	1928
<i>Amount (in millions)</i>											
January.....	M. 760.0	G.M. 51.0	M. 1,075.2 ¹	G.M. 23.5 ¹	M. 43,337	G.M. 12.7	G.M. 109.3 ¹	G.M. 215.6 ¹	G.M. 118.0	G.M. 101.1	G.M. 199.9
February.....	1,794.9	89.2	1,046.4	21.1	83,192	14.0	109.7	136.5	73.6	63.3	39.1
March.....	1,142.7	76.8	1,924.3	29.1	41,886	8.8	126.6	122.5	73.5	60.9	24.6
April.....	970.0	63.9	2,532.9 ¹	37.2 ¹	236,107	39.6	165.9	146.5	102.6 ¹	91.0	177.7
May.....	1,042.4	71.3	4,370.0	62.4	390,203	31.9	143.7	125.1	63.3	32.7	36.6
June.....	792.0	47.9	2,417.0	32.5	117,330	4.9	134.6	126.6	59.3	22.5	22.9
July.....	708.6	38.7	3,968.3	33.3	1,020,531	12.9	169.4	154.5	81.9	168.3	183.5
August.....	646.5	32.3	9,221.5	38.7	3,500,385	5.0	147.1	124.8	62.7	31.9	36.1
September.....	498.8	20.1	3,027.8	8.9	42 ¹	33.5	153.7	121.7	60.8	25.4	26.4
October.....	709.1	20.2	7,344.1	9.2	2,191 ¹	62.5	208.2 ¹	162.4 ¹	88.2	180.9	192.8
November.....	870.0	14.2	17,313.2	7.3	1,222,840 ¹	22.1	164.8	101.6	67.0	36.4	41.0
December.....	911.9	20.3	9,927.1	4.2	24,252,246 ¹	50.0	151.4	87.7	64.3	24.8	23.1
Total.....	..	G.M. 545.9	..	G.M. 307.4	..	G.M. 297.9	G.M. 1,784.4	G.M. 1,625.5	G.M. 915.2	G.M. 839.2	G.M. 1,003.7

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<i>Percentage Distribution</i>											
January.....	..	9.3	..	7.6	..	4.3	6.1	13.3	12.9	12.0	19.9
February.....	..	16.3	..	6.8	..	4.7	6.2	8.4	8.0	7.5	3.9
March.....	..	14.1	..	9.5	..	7.1	7.5	8.0	8.0	7.3	2.5
April.....	..	11.7	..	12.1	..	13.3	9.3	9.0	11.2	10.8	17.7
May.....	..	13.1	..	20.3	..	10.7	8.1	7.7	6.9	3.9	3.6
June.....	..	8.8	..	10.6	..	1.6	7.5	7.8	6.5	2.7	2.3
July.....	..	7.1	..	10.8	..	4.3	9.5	9.0	9.0	20.1	18.3
August.....	..	5.9	..	12.6	..	1.7	8.2	7.7	6.9	3.8	3.6
September.....	..	3.7	..	2.9	..	11.2	8.6	7.5	6.7	3.0	2.6
October.....	..	3.7	..	3.0	..	21.0	11.7	10.0	9.6	21.6	19.2
November.....	..	2.6	..	2.4	..	7.4	9.2	6.2	7.3	4.3	4.1
December.....	..	3.7	..	1.4	..	16.8	8.5	5.4	7.0	3.0	2.3
Total.....	..	100.0	..	100.0	..	100.0	100.0	100.0	100.0	100.0	100.0

¹ Rate increase effective.

² Rate decrease effective.

³ Amounts in italics are given in trillions because of the depreciation of the mark during this period.

TABLE 6: RECEIPTS FROM THE WEST VIRGINIA TURNOVER TAX, BY QUARTERS, FISCAL YEARS
1922 to 1928

(Source: Biennial Reports, State Tax Commission)

Quarters	July, 1921 to June, 1922	July, 1922 to June, 1923	July, 1923 to June, 1924	July, 1924 to June, 1925	July, 1925 to June, 1926	July, 1926 to June, 1927	July, 1927 to June, 1928
<i>Amount (in thousands)</i>							
Quarter ended September 30.....	..	\$487.0	\$730.2	\$524.8	\$531.7	\$698.3	\$987.1
Quarter ended December 31.....	\$392.5	564.4	655.6	518.4	727.2	758.9	810.5
Quarter ended March 31.....	630.4	997.7	1,035.8	934.0	1,179.7	1,286.9	1,174.6
Quarter ended June 30.....	439.5	659.3	634.4	573.9	720.6	1,332.0	832.9
Year ended June 30.....	\$1,462.4	\$2,708.4	\$3,056.0	\$2,551.1	\$3,159.2	\$4,076.1	\$3,805.1
<i>Percentage Distribution</i>							
Quarter ended September 30.....	..	18.0	23.9	20.6	16.8	17.1	25.9
Quarter ended December 31.....	..	20.8	21.4	20.3	23.0	18.6	21.3
Quarter ended March 31.....	..	36.8	33.9	36.6	37.4	31.6	30.9
Quarter ended June 30.....	..	24.4	20.8	22.5	22.8	32.7	21.9
Year ended June 30.....	..	100.0	100.0	100.0	100.0	100.0	100.0

payments spread over a year would be more convenient to most concerns than a lumped annual payment. The treasury of the taxing government receives its revenue in mass, and must forego the advantage of receipts spread throughout the fiscal year. The reduction of the number of returns to be handled is, of course, an administrative saving.

ADMINISTRATIVE SUPERVISION

Where a tax involves many thousands of returns it would be manifestly impossible to make a detailed check on each return. In this respect a general sales or turnover tax shares its problems with the income tax and with all other taxes which are assessed on many individual taxpayers. The weaker points in the levy and collection of the tax must be ascertained and administrative supervision must be concentrated on those points.

Innocent errors of interpretation of the law, misjudgments in accounting, and honest differences of opinion between taxpayer and administration that require judicial determination would occur rarely in a general sales or turnover tax with a uniform base, in which no special discriminations or exemptions were involved. The administration could focus its attention on fraudulent failure to report and on fraudulent misstatements of turnover. Supervision of the returns of large manufacturers and dealers could be largely nominal in many cases. The well-established firm that would tamper with its books to evade taxation would be the exception, not the rule. The weak points in the administration of a uniform general sales or turnover tax of any type would be the failure of small producers and dealers to file returns for the tax, and the wilful understatement of their turnovers by such producers and dealers.

Central or Local Administration

The dilemma of central versus local administration is particularly pertinent in general sales or turnover taxation, because unlike an income tax, a turnover tax can be administered by local resident agents with individual responsibility,

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and also by a central administrative authority. The turnover of a manufacturer or dealer would be a factor easier for local agents to assess than are property values under a general property tax.

The major advantage of local administration is the familiarity of the local official with individuals and business conditions in his neighborhood. A local resident agent, after several years' experience, can acquire a more personal knowledge of taxpayers in his district and of their circumstances than is possible for the most conscientious field agent of a central authority. The resident agent also acquires a personal knowledge of the possibility or probability of fraudulent returns from individual taxpayers.

This advantage of a system of local resident assessors and collectors is outweighed by serious disadvantages. The very personal familiarity of the resident agent with local conditions makes him more amenable to local influences and more likely to enter into collusion with taxpayers to approve fraudulent returns. Not being directly subject to central supervision, the resident agent may not build up the technique of assessment and checking which is possible under centralized administration. The resident agent's job may not be a full-time one, in which case he is likely to have competing outside interests. The fee system of payment employed to stimulate the activity of resident agents is often unfair in practice and leads to political abuse. The Pennsylvania Mercantile License Tax is administered by local resident agents known as "mercantile appraisers," and much of the administrative weakness of this tax can be traced to this element in the administration.

Failure to File Returns

The most difficult type of evasion to uncover is the failure to file a return, since the administration starts without knowledge or clues of the possible evasion. Pennsylvania has attempted to check such nonlisting by requiring the "mercantile appraisers," through whom the tax is administered, to advertise annually in local papers the list of taxpayers under the Mercantile License Tax, in the hope that business rivals will report unlisted names. Such advertisement is

expensive, amounting to between one-fifth and one-sixth of the total cost of administration of the tax in Pennsylvania.¹

A less expensive but equally effective means to the same end is to make the payment of a general sales or turnover tax the occasion of obtaining a license to do business of the class involved, and to require that the license so obtained be kept prominently displayed. This method, embodied in the Philippine Islands' turnover tax, allows business rivals, or other interested parties, as good an opportunity of learning whether an individual concern's tax has been paid as does the Pennsylvania system of advertising. If no return is filed, of course, no license to do business is obtained, and competitors or the taxing government itself can take steps to close down an unlicensed establishment.

Understatement of Turnover

Any system of administration, centralized or local, would be powerless to review and investigate all returns under a general or sales turnover tax. Large dependence must be placed on the honesty of the reporting taxpayers. Experience has shown that all but a minute fraction of the returns of large taxpayers are honest within the scope of the law; a large taxpayer will take every legal advantage of the phrasing of the law and will decide all doubtful points in his own favor, but he will not wilfully state incorrect figures. In the case of a turnover tax with a uniform base, where the possibility of misinterpretation, wilful or innocent, would be at a minimum, these large taxpayers would present no serious problem. The more doubtful honesty of small taxpayers can be stimulated by two methods—the fiscal oath and the occasional unannounced check.

Nearly all tax laws require the taxpayer to sign on the return and swear to an affidavit that the return is true. Long experience has shown that such an affidavit is a real safeguard against fraud. Whether it is that the taxpayer attributes a greater moral solemnity to the sworn statement than to the unsworn one, or because he fears the legal penalties of perjury in the case of false sworn statements, the fiscal oath

¹ Leonard P. Fox, "Taxation for State Purposes in Pennsylvania," Harrisburg, 1925, p. 110.

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markedly reduces evasion. This circumstance is widely known to administrators, and it might be thought that the fiscal oath would be made inseparable from all tax returns. As a matter of practice, this important detail is often omitted, and tax returns are accepted without a signed and sworn affidavit. For example, in Allegheny County, Pennsylvania, the mercantile appraisers under the Mercantile License Tax in 1923 accepted over 2,000 returns without sworn affidavits.¹ Strict adherence to this detail is a long step towards prevention of evasion.

The occasional unannounced check serves as an incentive towards honesty in making out tax returns by holding the threat of discovery and punishment over the heads of possible evaders. A flying squad makes the rounds of communities in the taxing jurisdiction. It can not, nor is it expected to, cover all returns for the year. If it covers only a few communities in the course of the year, it serves its purpose. In each community, it goes thoroughly into the returns of the taxpayers of that district, checking their returns against their business books and accounts. Where frauds are uncovered, the penalties of the law are laid on the offenders, care being taken that full publicity is given to such cases. The federal tax administration and the more active state administrations have found this system effective for taxes of various types. There would be no bar to its application to a general sales or turnover tax.

CONCLUSIONS

Uniformity and universality in a general sales or turnover tax—uniformity of its rate, universality in its application to all business activity, and universality in its application to all sales of commodities and the performance of all business services—would reduce its administrative difficulties to a minimum. If every type of business activity were taxed, there would be no problem of hairline exemptions or exceptions. If all commodities and services were brought under the tax, there would be no inducement to taxpayers to list taxable sales as non-taxable. Keeping a record of total sales would not constitute a special accounting burden for most tax-

¹ *Ibid.*, p. 108.

payers, and would be the easiest type of record for the administration to check.

Divergences from this uniformity and universality would open avenues of avoidance and evasion and would increase the burden of administration. In the case of a commodity transfer tax which does not cover the performance of services, issues would be sure to arise between taxpayers and the administration as to whether certain classes of sales involved commodities or the performance of business services. A production tax applying to all commodities once, and once only, in the course of their production and distribution would necessitate a complicated system of licensing producers and dealers and would demand an intricate system of accounting from the taxpayers. Under a retail sales tax there would be the possibility of evasion by manufacturers and wholesalers making retail as well as wholesale sales.

Serious administrative difficulties would also result from exceptions or exemptions as to commodities subject to the tax. The exemption of necessities or other categories of articles would compel producers and dealers to keep double sets of accounts, one for taxable sales and the other for non-taxable sales. It would be difficult for the administration to discover wrong classification of sales as between taxable and non-taxable groups, whether this wrong classification were deliberate or innocent.

State and local governments levying multiple-turnover taxes have provided certain discriminations, for economic or constitutional reasons, which have complicated the administration of these taxes. They have set lower rates on the sales of wholesalers than on the sales of manufacturers or retailers, and have exempted entirely the sales made by wholesalers and other merchants to customers located outside the state. The distinction between these classes of enterprise is often very fine, and taxpayers belonging to the higher-taxed classes, ever alert to give themselves the benefit of any shadow of doubt, seek to list themselves in the lower-taxed classes. This often involves litigation, as well as the initial trouble to the administration to discover the wrong classification. The exemption of interstate sales compels merchants to classify their sales into two categories, taxable

CHAPTER IV

APPLICATION OF GENERAL SALES OR TURN-OVER TAXES

GRANTING that a turnover tax must apply to all sales (allowing for exemption of specific sub-classes), there yet remain wide possibilities of variation. The tax may be confined to one class, as in the case of the retail sales tax or the production tax, or it may be extended to several categories of sales, as is the general turnover tax. The specified exempted sub-classes of sales within the taxable category, or categories, may be broadened or narrowed.

The scope of a general sales or turnover tax hinges upon two elements: first, whether the tax is a multiple or single-turnover tax, *i. e.*, whether tax liability accrues each time an article or property is sold and bought in its progress from original producer to ultimate consumer, or once only in the course of this industrial and mercantile progress; and second, the categories of commodities, property rights and services whose sale or performance gives rise to tax liability.

MULTIPLE-TURNOVER TAXES COMPARED WITH SINGLE-TURNOVER TAXES

Although general sales or turnover taxes are usually viewed as "consumption" taxes, that is, taxes embodied in the long run in the prices of articles bought to be consumed, and whose burden is therefore borne by the general consuming public, it is not essential to the concept that only properties, commodities or services purchased by individuals for their personal consumption should be reached by such taxes. Properties, articles and services which contribute indirectly to personal consumption by entering into the productive processes of consumption commodities, or which yield consumable services, are in practice, and properly so, covered by general sales or turnover taxes. Normally, from three to a half dozen industrial and commercial processes, each of

them involving change of ownership through a sales transaction, intervene between the production of the raw materials that enter into a commodity and its final purchase by a consumer. A general sales or turnover tax may be so levied as to rest on a single stage of the industrial and commercial progress of each article or service, or it may apply at every stage.

The legislator's choice between the single-turnover tax and the multiple-turnover tax must be guided by economic, by legal, by administrative and by fiscal considerations. The first three aspects have been dealt with in the preceding chapters. The revenue aspect of the issue and its relation to the classes and services made taxable are examined in the pages that follow.

Fiscal Considerations

Given a multiple-turnover tax and a single-turnover tax, both extending to the same classes of commodities or articles, tax liability under the multiple-turnover tax would occur on all occasions covered by the single-turnover tax, and also on many other occasions. In contrast with a retail sales tax, a commodity transfer tax would apply to all retail sales, and in addition, to all transactions leading up to the retail sales. Similarly, in contrast with a production tax, a commodity transfer tax would apply to sales by manufacturers of the articles they produced, and moreover, it would extend to the prior sales of raw materials and unfinished articles and to the subsequent sales of the finished articles by wholesalers and retailers. Were a multiple-turnover tax and a single-turnover tax, covering the sales of the same commodities, levied at the same rate, it is evident that the former would produce more revenue than the latter. If we assume identical rates for the two taxes, the ratio of the revenue yield of a multiple-turnover tax to the yield of an otherwise corresponding single-turnover tax would depend on two factors: first, the average number of turnovers that commodities experience in their progress from raw material to finished product in the hands of the final consumer; and second, the average value per turnover as compared with the value of the turnover on which the single-turnover tax is based.

When the French fiscal administration proposed the substitution of a multiple-turnover tax for the existing single-turnover tax in 1920,¹ it estimated five turnovers per commodity as the general average. This estimate proved too high, particularly for France, where specialization of industrial and commercial processes has not proceeded as far as in the United States. A calculation made in the United States in 1920² of the average number of turnovers for a series of standard commodities showed the following results: granulated sugar, four turnovers; bread, three turnovers; beef, three turnovers; pork, three turnovers; a \$60 suit of clothing, six turnovers; an \$8 pair of overalls and jacket, five turnovers; a \$2.25 pair of service gloves, six turnovers; taffeta silk at \$2.25 per yard, four turnovers; a \$35.10 rubber tire, five turnovers.

Moreover, in estimating the possible yields of a commodity-transfer tax and of a retail sales tax, it can not be assumed that the yield of the former will equal the yield of the latter multiplied by the average number of turnovers per commodity. The French fiscal administration made this assumption in 1920, with disastrous results to the budget.³ In the early stages of its industrial and commercial progress, the value of an article is but a small fraction of its final value. In fact, so high are the distribution costs of many commodities that the greater part of their value is derived from the last one or two stages of their distributive progress. Consequently, the tax on an early turnover of an article's industrial progress would be only a fraction of the tax on the final retail sale. In general, each additional turnover involved in the industrial and distributive progress of a commodity results in a less than proportional increase in the pyramided tax upon it.⁴

The ratio of the yield of a retail sales tax on the final purchase of any given article to the yield of a pyramided commodity transfer tax imposed on all transactions of that article would depend upon the number of turnovers usually

¹ See p. 171 of this volume.

² Meyer D. Rothschild, "The Gross Sales or Turnover Tax," National Tax Association, "Proceedings of the Thirteenth National Conference," 1920, pp. 197-202.

³ See p. 171 of this volume.

⁴ Popitz, "Kommentar," pp. 12-13

experienced by the selected article in the processes of its manufacture and distribution, and also upon the value of the selected article at its various turnovers. Since there is wide variation between commodities and articles as to these factors, it must be anticipated that there would be marked differences in the yield ratios of the two types of taxes for individual articles. Thus, the average ratios of the yield of a retail sales tax to that of a pyramided commodity transfer tax for the series of articles whose turnovers were noted above would be: sugar, 29.1%; bread, 52.1%; beef, 20.8%; pork, 59.9%; a \$60 suit of clothing, 38.3%; an \$8 pair of overalls and jacket, 40.5%; a \$2.25 pair of service gloves, 35.7%; taffeta silk retailing at \$2.25 per yard, 50.0%; a \$35.10 rubber tire, 30.7%.¹ A similar calculation, based on data derived from the German turnover tax, shows an analogous situation in Germany: the ratio of the yield of a retail sales tax to that of a pyramided commodity transfer tax for bread in 1924 was 51.0%; the ratio for beef was 49.0%; that for agricultural machinery varied from 32.7% to 80.6%, according to the number of turnovers involved; the ratio for a boiler involving four turnovers was 62.3%; and the ratio for textiles varied between 32.9% and 50.0%, according to the number of turnovers.² All in all, a commodity transfer tax otherwise comparable with a retail sales tax yields from two and a half to three times as much revenue as a retail sales tax.

The contrast between the yields of a commodity transfer tax and of a production tax, levied on the same classes of articles and at the same rate, would be even greater than the disproportion between the yields of a commodity transfer tax and of a retail sales tax. Unless sold directly by the producer to the consumer, the production cost of an article is often considerably smaller than its retail sales price. Consequently, the yield of a production tax at a given rate on the same classes of commodities would be less than the yield of a retail sales tax at the same rate. The difference between the yields of the two taxes would be determined by the difference between the average retail price of articles and their average manufacturers' price. The yield of a commodity

¹ Rothchild, *op. cit.*

² Luther "Denkschrift," pp. 15-16.

transfer tax at the same rate, of course, would far exceed that of a production tax.

Legislatures are not limited to a given rate at which a general sales or turnover tax, whether it be a multiple-turnover or a single-turnover tax, must be levied. Rather, they seek to raise a certain revenue from a turnover tax, and adjust the rate according to the character of the tax, so as to produce the needed revenue. Therefore, other considerations aside, a legislature has the choice of a multiple-turnover tax at a given low rate or a single-turnover tax with a rate several times higher. It is axiomatic that there is less popular dissatisfaction with a low-rate tax, and fewer attempts to evade or avoid it, than with a high-rate tax. This axiom holds true even though the low-rate tax, because of its pyramiding, produces equal or more revenue in the end than the high-rate tax. The advantage, of course, is somewhat offset by the fact that a multiple-turnover tax usually applies to more taxpayers than does a single-turnover tax.

From a purely fiscal point of view, then, on the basis of revenue yield, a multiple-turnover tax has advantages over a single-turnover tax.

Relation to the Scope of the Tax

The choice between a multiple-turnover tax and a single-turnover tax determines to some extent the character and types of transactions included in the scope of the tax. Single-turnover taxes have a narrower scope than multiple-turnover taxes. Retail sales taxes can logically apply only to sales of commodities for personal consumption and to personal services; in practice, personal services are omitted from the scope of retail sales taxes. Production taxes are levied on the creation of producers' articles—machinery and equipment—as well as on commodities intended for personal consumption. The taxation of the sale of real property, of capital property, of intangibles and of personal rights does not properly come under the scope of a single-turnover tax, since these properties do not have a defined life or term of existence, during which they may be taxed once, but only once, as is the intent of a single-turnover tax.

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There are no logical limitations to the scope of a multiple-turnover tax except those dictated by the choice of legal "subject."¹ In practice, however, most multiple-turnover taxes take the form of commodity transfer taxes and are confined to the sales of commodities by their producers and dealers. The taxation of incidental personal sales of landed and capital properties, of intangibles and of services under general turnover or gross sales taxes raises special economic and administrative problems, which are considered in the next section of this chapter.

SPECIAL CLASSES OF TAXABLE SALES TRANSACTIONS

The single-turnover taxes and the more common form of multiple-turnover taxation—the commodity transfer tax—are limited in their scope to business transactions in articles or commodities. The scope of the broader general turnover tax is not so clearly defined, and questions arise whether it can or should extend to such categories of transactions as sales of commodities and tangible properties, to transfers of real and capital property, to sales of intangibles and to the performance of services. Each of these special classes of transfer or sales transactions raises issues of an economic, legal or administrative character, and deserves individual consideration.

Taxation of Incidental Sales of Commodities

An incidental sale of a commodity or a tangible property (such as a used piece of machinery or office equipment) may be loosely defined as one made outside the course of an individual's or firm's conduct of business, particularly where no element of seeking to make a profit over costs enters the transaction. The taxation of such incidental personal and business sales is not contemplated by most turnover tax statutes. The determining element in the case would appear to be the legal "subject" of the tax; incidental sales are taxed only by those countries which base their turnover taxes in whole, or in part, on "sales transactions." Within the limited scope of its tax (covering only non-retail sales by

¹ See pp. 74 ff. of this volume.

manufacturers and merchants), Italy taxes all incidental sales made by business concerns. The Roumanian turnover tax extends to all incidental sales. Belgium and Czechoslovakia (and formerly Jugoslavia) tax incidental sales over stated amounts. The French turnover tax, which is based on "business activity" and not "sales transactions," permits the taxation of incidental sales by a business concern when they are of such character that, were they made habitually and regularly for profit, they would subject the concern making them to the allied Industrial and Business Profits Tax. West Virginia taxed incidental sales of commodities or tangible properties in excess of \$10,000 under its Gross Sales Tax, based on "sales transactions," but when the subject of the tax was changed in 1925 to "business activity," and the tax was named the Business Occupation Tax, the taxation of incidental sales was dropped.

The limitation on taxing incidental sales of commodities or tangible properties when the legal "subject" of a turnover tax is "business activity" or "production" does not result in a significant restriction of revenue from the turnover tax. When such individual sales are brought under a turnover tax, it is difficult and expensive for the administrative authorities to obtain record of them. Moreover, the volume of such incidental sales is relatively low and the revenue from them is too small to warrant any thoroughgoing attempt to prevent evasion of the tax on such sales.

Taxation of Land Transfers

Land transfers or sales are not a routine element of the business activity of manufacturing or mercantile concerns. Therefore, a turnover tax based on "business activity" would exclude them, except in the case of real estate firms, although they might well come within the scope of a turnover tax based on "sales transactions."

The foreign turnover taxes do not cover directly the sales of landed property, but in practically all of the European countries there are special transfer or "mutation" taxes applying to the sale of real property. These mutation taxes must not be considered purely supplemental to the turnover taxes of these countries; in most cases the land transfer or

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mutation taxes antedated the turnover taxes, and their rate schedules are usually unrelated. Land transfer taxes have never been a part of the American state tax systems (though the fees upon the legal documents essential to land transfers have in many cases taken on the character of revenue taxes). West Virginia taxed all land transfers of over \$10,000 value under its earlier Gross Sales Tax, but the present Business Occupation Tax reaches such sales only when they constitute the regular business of an individual or firm.

From an economic point of view, there is a strong argument against covering the sale of realty by a general turnover tax that is intended to be either a consumption tax distributed to, and resting upon, the general population, or a tax on business activity. Land is not a commodity that follows a more or less prescribed course of manufacture and distribution, with a determinable number of turnovers between the stage of raw material and purchase by the consumer, so that each unit reaches a consumer burdened by approximately the same amount of tax. Land transfers constitute an element that does not fit into the rationale of general sales or turnover taxation. There may be independent justification for a land transfer tax as a deterrent to speculation and for other reasons, but the justification does not extend to it as an element in a turnover tax.

Taxation of Capital Value Transfers

The case against a general sales or turnover tax on sales of capital property other than realty—sales of entire business enterprises, including plants and good-will, as distinguished from incidental sales of tangible properties—is even stronger on economic grounds than is that against the taxation of land transfers. The inequity of the distribution of the burden of such a tax would be greater than that of a land transfer tax, because there is even less uniformity in such sales than in land transfers; it would fail as a consumption tax, and it would be highly inequitable if its object and result were to burden business enterprise directly. The administrative difficulties of such a tax would be great; keeping accurate track of all such transactions would be difficult, if not impossible, in practice. The yield of the tax

might be considerable in a period of corporate consolidations and mergers, but at the risk of penalizing advantageous regroupings of business capital. These considerations persuaded Germany to forego a proposed tax on capital transfers which was suggested in 1921.¹ Capital value transfers, however, were brought under the turnover taxes of Austria, Hungary and Jugoslavia; there is no account of the effectiveness of this feature of the turnover taxes of these countries.

Taxation of Transfers of Intangibles

Intangible properties—including ownership rights in capital property, as represented by stocks, negotiable or assignable choses in action, and capital rights such as patents and royalties—are like real and capital properties, and unlike commodities, in that they have no set economic career of production and distribution. Any tax on the transfer of such intangible properties would lack an element essential to the economic character of a general sales or turnover tax; it would not constitute a uniform burden within the classes of objects to which it applied. Consequently, a transfer tax on intangibles must fail of being fairly distributed by any standard, either directly on business enterprise, or by shifting on the general consuming public. It may reach certain elements of taxpaying ability not tapped by other parts of a tax system; it may have the desirable indirect effect of curbing certain types of transactions; and it may be especially practicable administratively. These considerations may justify it as a tax *per se*, but will not establish it as an element of general sales or turnover taxation.

The transfer of corporate stocks and negotiable bonds provides a convenient base for an indirect tax, because of the large values involved and their wide-spread ownership, and because the greater part of these transactions is negotiated through the hands of a limited and easily ascertainable number of investment houses and brokers. Such transfers, however, enter neither directly nor indirectly into individual personal consumption, nor are such sales made by the owners

¹ Rolf Grabower, "Die Geschichte der Umsatzsteuer und ihre gegenwärtige Gestaltung in Inland und in Ausland," Berlin, 1925, p. 210.

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of the securities as a regular business activity, except in the case of a limited group of speculators. A stock transfer tax of the type levied in New York State or a general security transfer tax of the type commonly levied in European countries, while justified on various grounds, has no logical connection with a general sales or turnover tax intended as a consumption tax or levied as a tax on general business activity. Consequently, although stock and security transfer taxes are not unfamiliar in this country and abroad, they are levied independently of any general sales or turnover taxes that may be in force.

Assignable choses in action constitute another category of intangibles which it would be unwise to bring within the scope of a general sales or turnover tax. Assignable claims bear no direct or indirect relation to general consumption, nor can they be assumed to enter as an aspect of any regular business activity. It would be inequitable to levy, and difficult to administer, a tax on such transfers. The same disadvantages that apply to the taxation of other forms of capital property would also be operative were a turnover tax extended to intangible capital rights—patents, copyrights, royalties and the like. Only Germany, by implication, and Czechoslovakia, by specific mention, at present tax intangible capital rights under their turnover taxes.

A final class of intangibles deserves special consideration. Checks and other negotiable instruments are sometimes treated as means of payment, sometimes as properties bought and sold. A general turnover tax extended to intangibles might theoretically cover negotiable instruments intended not as mere means of payment but entering into transactions as properties. It would be administratively impossible to separate the two uses of negotiable instruments, however, as the law draws hair-line distinctions in this issue which would not make a clear basis for tax liability. Many countries levying turnover taxes also tax checks and other negotiable instruments. These special taxes on credit instruments, however, are independent of the turnover tax systems of these countries. Such taxes may have a place and a justification as independent levies, but not as elements of a turnover tax.

Taxation of Services

The value of commodities and properties to the purchaser lies in the services they render to him. The services rendered by commodities arise out of their consumption and consequent destruction; the services derived from capital properties develop directly or indirectly over a period of time. There is a third category of services which may be rendered directly by the seller to the purchaser without the intervention of commodities or properties. This group includes transportation and construction, industrial services such as those of the artisan, commercial services such as those of the commission broker or the insurance company, and the services of the professions. Should these be brought within the scope of a turnover tax?

Special problems arise when a turnover tax is extended to the services of transportation and transmission companies. In the European countries, where the instrumentalities of transportation and transmission are government utilities, their services are exempted from turnover taxation on this ground, even when the scope of the tax is so broadened as to include services generally.¹ In the United States there would be a different reason for excluding transportation and transmission services from state general sales or turnover taxes. The federal constitutional limitation on the power of the states to tax interstate commerce would prevent taxation of the services of transportation or transmission companies as a part of the turnover tax system of any particular state. This limitation, of course, would not apply to the Federal Government, which would be free to extend a general turnover tax levied by it to such services.

In its economic aspects, the taxation of services does not contradict the aims of general sales or turnover taxation. The taxable categories of services may enter ultimate individual consumption only in small part. However, they are sufficiently broad and uniform in their entry into industry and business to ensure smooth and even distribution in the event that taxes upon them are included as business costs in prices and are shifted. Such instances of pyramided taxation as might occur through taxing the services performed by

¹See pp. 50-51 of this volume.

subcontractors would not be more serious than the pyramiding which occurs in the taxation of commodity transfers.

The taxation of sales agents and commission brokers under a general turnover tax also offers some difficulty. In the first place, if a law makes "sales transactions" the legal subject of a general sales or turnover tax, a strained construction of the concept of "sales transactions" would be required to extend it to cover the services of sales agents or commission brokers. The act of transporting goods by a railroad company, the act of transmitting a message by a telegraph company, the building of a house by a construction company, the attendance of a doctor—all of these services are acts which can be thought of as being "sold" for given prices quite as readily as commodities or properties. The sales agent or commission broker performs a service just as definite as these others—that of purchasing or selling for his principal; his commission is as much a "price" for his service as is the fare of a transportation company or the fee of a doctor. This difficulty is thus more apparent than real. Italy, which taxes such services, makes their inclusion doubly sure by specifically declaring them to be taxable sales transactions. Another solution of the difficulty would be to enlarge the statement of the legal subject to "sales transactions and services." No such problem arises, of course, when "business activity" is made the legal subject of the tax, as the services of agents and brokers are clearly forms of business activity.

A second problem with respect to the application of general sales or turnover taxes to selling and purchasing agents and commission brokers is whether the tax on them should be measured by the gross value of sales made by them or only by the commissions they receive for negotiating such sales. If their activity be viewed purely as a service which they perform for their principals, then the amount of their commissions is the only valid measure of the tax upon them, irrespective of whether the legal subject of the tax is "sales transactions and services" or "business activity." This has been the position taken by the French and German turnover taxes and by the West Virginia Business Occupation Tax. Several European countries, however, choose to treat the

transfer between principal and agent or broker as one independent sales transaction, and the sale by the agent or broker as a second independent sales transaction. Under this view of the sales agent's or commission broker's activities, he is taxed on the gross value of the turnovers negotiated by him.

The application of a turnover tax to professional services raises its own issues. The payment for the services of the doctor, the minister, the lawyer and the artist is not determined in an open market, and there is a strong possibility that a tax on such services is not shifted to the purchaser but is borne by the practitioner of the profession. The gross income of a professional man more closely approximates his net income than in the case of industrial or commercial concerns. Consequently, an unshifted tax on professional services does not result in the same inequalities within the group that an unshifted turnover tax on manufacturing or mercantile establishments does,¹ but even if it were regarded as a special income tax on the profession, this would be contrary to the general intent of a turnover tax levied as a consumption tax. It would be doubly regrettable in view of the cultural aspect of the professions. The foreign turnover taxes, with the exception of those of Germany, Austria and Czechoslovakia, exempt the skilled professions—some because of the character of the turnover taxes as taxes on "business enterprise" (under which heading the professions are not included), others because of the economic and cultural considerations noted above. ✓

CONCLUSIONS

If it were desired to raise a given revenue from some form of general sales or turnover taxation, a multiple-turnover tax could be levied at a much lower rate than a single-turnover tax to yield that revenue. A multiple-turnover tax at a low rate would probably provoke less dissatisfaction and fewer attempts at evasion than a single-turnover tax with a high rate. This advantage of a multiple-turnover tax must be considered together with its administrative advantages and its economic disadvantages noted in previous chapters.

¹ See p. 50 of this volume.

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General sales or turnover taxes, in particular multiple-turnover taxes, need not logically be confined to business sales of commodities. According to their legal "subjects," they might be extended to the performance of industrial, commercial and professional services, to sales of land, to sales of capital properties, to sales of intangible values, and to incidental sales of commodities and properties. Administrative or economic considerations exclude from the scope of a general sales or turnover tax all of these categories of transactions except industrial and commercial services.

CHAPTER V

PROBLEMS OF IMPORT AND EXPORT

IN MOST countries where general sales or turnover taxes have been levied, it has been assumed that such taxes introduce a discriminatory element into the prices of articles of domestic production and manufacture as compared with the prices of articles of foreign production and manufacture. Efforts have been made to compensate for this presumed discrimination by the levy of special taxes on the importation of competing foreign goods, and by relieving exported goods of a part of the burden, at least, of the domestic turnover tax.

The economic effects of a turnover tax levied by one country on the sale of domestic goods, when these goods compete in either domestic or foreign markets with goods produced in countries levying lighter turnover taxes, or none, are determined by the same considerations that were discussed in a preceding chapter which dealt with general sales or turnover taxes levied by states or other limited jurisdictions.¹ When comparing the relative tax costs that tend to be embodied in the prices of goods from two taxing localities, states or countries, a turnover tax levied by one and not by the other can not be considered independently. It must be viewed as an alternative for some other form of tax that would have raised an equivalent revenue, and which, unless it were a net income or net profits tax, would also have tended to enter the prices of the goods produced in that locality, state or country. The distinguishing element of the turnover tax is its discriminatory effect upon goods produced or sold under particular circumstances—large turnover as compared with capitalization or net profit. These particular discriminations are not compensated for in any of the import turnover duties or export turnover allowances. No workable system of duties or allowances could take them exactly, or even roughly, into account.

¹ See pp. 30 ff. of this volume.

Also, it should be noted, a retail sales tax could never possibly involve a discrimination against domestic manufacture and production and in favor of foreign goods. Foreign goods, when they eventually entered retail sale in the importing country, would be subject to a retail sales tax on exactly the same terms as domestic goods. In the case of exported domestic goods, a retail sales tax would not have been applied to them before they were exported, so that they would enter foreign markets unhampered by any domestic turnover tax burden.

The whole system of special import turnover duties or export turnover allowances arranged to offset the competition of foreign producers, presumably free of any turnover tax burden, is based, it is clear, on questionable economic reasoning. Nevertheless, such special import and export provisions are the general rule in the countries levying general sales or turnover taxes. Special discriminations in national turnover tax systems intended to protect domestic importers and exporters are also common.

IMPORT DISCRIMINATIONS

The importation of goods by a country levying a general sales or turnover tax from a country levying no such tax or a lighter turnover tax has been viewed by foreign legislators as raising two independent problems. The first is the problem of protecting taxed domestic production from the competition of foreign production presumably free of any turnover tax burden. The second problem is how to protect taxed domestic importers from the competition of foreign exporters presumably not burdened by any general sales or turnover tax.

Neutralizing Foreign Turnover Tax-Free Competition

All of the countries levying turnover taxes, except Germany, Czechoslovakia and Poland, tax the act of importation with a view to compensating for the import premium which, it is assumed, a turnover tax on domestic production and manufacture gives to foreign production and manu-

facture.¹ It is generally recognized that, assuming a discrimination to exist, the taxation of the act of importation at the uniform rate of the domestic turnover tax does not exactly compensate for such assumed discrimination. Manufactured articles in the form in which they are imported may be the result of a series of turnovers; the price of domestic articles at the same stage may embody a pyramided tax considerably heavier than the statutory rate of the tax. The levy of a turnover tax at the statutory rate on the import value of imported articles would not put them on a competitive equality from the point of view of the turnover tax if this tax actually did result in discrimination, unless the domestic turnover tax were levied as in Canada in the form of a production tax. Only Austria, which consolidates its internal general sales or turnover tax, logically estimates for each imported article the consolidated rate which would have been levied upon the same domestic article at the same stage of manufacture, and levies this consolidated rate on the imported article, thus placing imported articles on an exact parity with domestic goods as regards turnover taxation.² This parity, however, is achieved only by long and complicated rate schedules rivaling protective customs schedules in their hair-splitting detail.

Certain classes of imports are generally excepted from the special turnover taxes levied at importation. Raw materials necessary for domestic industry, and in general not domestically produced, are usually exempted from import turnover taxes, though their subsequent transfers may be subject to the internal turnover tax. Foodstuffs and other necessities, when exempted from domestic turnover taxation, are generally excepted from the import turnover tax, since the domestic producer in such cases is not placed at any competitive disadvantage by the turnover tax. Imports bonded for subsequent re-export after storage or after further process of manufacture are either exempted initially from the import turnover tax or are allowed a rebate of the tax on re-export. The Belgian tax law also allows exemption of the import

¹ See, Rolf Grabower, "Die umsatzliche Behandlung des Auszenhandels in Deutschland und in Ausland," *Steuer und Wirtschaft*, Vol. III, pp. 1199-1216.

² See, League of Nations, International Economic Conference Document No. 34, 1927, pp. 25-26.

turnover tax in the rare case where exported goods are re-imported by the original exporter without a transfer of title having occurred.

Protection of Domestic Importers

If no turnover tax is laid on the act of importation, a domestic manufacturer or dealer who purchases goods from abroad through a foreign export house, which in turn has purchased the goods from a foreign manufacturer, pays no domestic turnover tax on the transaction. The domestic manufacturer or dealer who purchases his foreign goods through a domestic importer who has dealt directly with the foreign manufacturer, pays on the transaction between the importer and himself. If a turnover tax is levied on the act of importation, then only one tax is involved in the purchase of foreign goods through a foreign export house, whereas two taxes must be paid if the purchase is made through a domestic importer. Assuming that the exporting country does not tax the transaction between the manufacturer who produces the exported goods and the exporter who directly negotiates the sale to the manufacturer or dealer in the importing country, importation through a domestic importer bears a heavier turnover tax burden than importation through a foreign exporter. Some of the European countries levying turnover taxes have sought to eliminate this assumed discrimination against domestic importers by a modification in the uniform application of the turnover tax.

This modification may take one of two forms. It may be accomplished by relieving the domestic importer of the tax on his resale, or it may be accomplished by levying a surtax on sales not made through domestic importers. The waverings of the French tax law on this issue provide examples of both forms of modification and illustrate the problems to which they give rise.¹

The French turnover tax law of 1920, which levied a turnover tax on the act of importation, also levied a surtax, doubling the rate of the turnover tax on goods imported from abroad without the mediation of a domestic importer or of the domestic branch of a foreign exporter. Apart from this

¹ Allix and Lecerclé, "La taxe sur le chiffre d'affaires," pp. 223-231.

special provision, goods imported through a domestic importer or the domestic branch of a foreign export concern paid a turnover tax at two points—once on the occasion of their importation and a second time on their sale by the importer or the branch of the foreign house to the domestic purchaser. The surtax caused goods purchased directly from abroad to sustain a double tax, thus placing them, as far as the turnover tax was concerned, upon an equality with goods imported through a domestic importer, and safeguarding the latter from discrimination. This provision, however, caused French manufacturers to pay a double tax on all imported raw materials essential to their production. This was felt to be a halter on French industry. It would appear that the most reasonable solution of this difficulty would have been to have exempted foreign raw materials essential to French industry from all turnover taxes on importation—from the importation turnover tax itself, from the surtax on direct importation from abroad, and from the turnover tax on resale by domestic importers. Instead, the French legislature, in this same turnover tax law of 1920, merely abolished the surtax on direct importation through foreign exporters when these exporters shipped goods originating in their own countries.

The exemption practically nullified the protection given to domestic importers by the surtax. Foreign export houses were free to ship goods produced in their own countries, whether manufactured articles or raw materials, to French purchasers without paying the surtax; they paid a turnover tax on the transaction once only, while a French importer handling the same transaction had to pay two taxes, one on importation and one on resale to the French purchaser. Moreover, fraud was widespread. Foreign exporters found that they could concoct false evidences of origin and thus ship into France goods from other countries than their own without paying the surtax.

In 1925 the law was radically changed. The importation surtax was abolished entirely for a specified list of raw materials. To protect the domestic importer, it was provided that his resale of such articles to domestic purchasers was exempted from the internal turnover tax. Thus, whether a

French purchaser obtained foreign raw materials directly from a foreign exporter or through a domestic importer, the imported goods reached him burdened by only a single turnover tax.

In the case of foreign manufactured articles obtained through a French importer, no exemption was allowed on the importer's resale, so that the goods reached the purchaser burdened by two turnover taxes. To protect the importer, however, a special surtax in addition to the turnover tax on importation was levied on the purchase of foreign manufactured goods directly from abroad when these goods were to be consumed or used by the purchaser. This "purchase tax," as it was called, was equal in rate to the turnover tax. If the goods were to be resold in their original state, the "purchase tax" was not levied. In 1926 the exemption from the "purchase tax" was extended to articles resold after further process of manufacture. The "purchase tax" resulted in administrative complications and, in view of the broad character of the exemptions under the 1926 amendment, it accorded French importers little protection. It was abolished in 1927.

A general turnover tax or a commodity transfer tax necessarily works slightly to the disadvantage of the domestic importer, to the extent that he must compete with foreign export houses shipping directly to domestic purchasers, if the exporting country does not levy a turnover tax or some other tax constituting an equivalent burden on the purchases of the foreign exporting house. As a matter of practice, many of the countries levying turnover taxes exempt the purchases of export houses, and no country levies any special tax on exporters that would counterbalance their exemption from turnover taxation. Since the discrimination exists, it is not unreasonable for the countries levying turnover taxes to guard their domestic importers against it. French experience shows that counterbalancing importation surtaxes or "purchase taxes" on transactions with foreign exporters fails of its purpose. The simplest and most effective solution of the problem is the exemption of resales by domestic importers. This exemption can be allowed whether or not the act of importation itself is subject to turnover taxation.

The exemption of the "first inland sale" after importation is a common feature of the European turnover tax laws.

EXPORT DISCRIMINATIONS

The export problem in turnover taxation is the reverse of the import problem. It also has two aspects—the protection of domestic manufacture and production taxed under the turnover tax in its competitive struggle in foreign markets with foreign manufacture and production presumably free of any turnover tax burden, and the protection of domestic export concerns from a discriminatory tax burden as compared with foreign import concerns. The same illusions as to differences in tax burdens on production and manufacture caused by turnover taxation, the same impossibility of complete logical solution on the basis of the assumed difference in tax burdens, characterizes both problems.

If it were true that a turnover tax laid a differential tax burden on domestic production and manufacture that would operate against it in foreign markets, logic would require that goods intended for export should be exempted from turnover taxation on all occasions when it would apply, or else that the full amount of the tax paid on each article should be reimbursed at the time of its export. The first proposal would be impossible in practice because goods intended for export can not be distinguished from goods intended for domestic consumption in most stages of their production. The second solution would likewise be generally impractical because of the impossibility of determining the amount of pyramided turnover tax embodied in the prices of goods at the time of their export, unless the tax is a general excise or is consolidated, and because any such reimbursement would operate in many cases as a bonus to exporters and would not always reduce the prices of the goods placed on foreign markets.¹

With the exception of Canada, Austria and Hungary, which allow reimbursement of the tax on export in certain cases, the countries levying turnover taxes content themselves with exempting the export sale itself from taxation.

¹Luther, "Denkschrift," pp. 12-13.

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With the same end in view, and also with the idea of protecting domestic exporters, the sales to such exporters are also usually exempted. This exemption of export sales and sales to exporters, of course, relieves the goods placed on foreign markets of a tax burden which might have otherwise interfered with their position in these foreign markets, but this relief has little, if any, relation to any differential turnover tax burden actually incorporated in the prices of exported goods. For a time, Germany and Czechoslovakia reversed this normal procedure by taxing the sale to the exporter and reimbursing him on proof of export.

CONCLUSIONS

There is little evidence that a general sales or turnover tax discriminates against domestic producers as compared with foreign producers. Under the circumstances, import turnover taxes and export turnover tax rebates are based on questionable economic theory. The operation of an import turnover tax is simply that of a special import duty with the normal revenue and protective aspects of such a duty; the export turnover tax rebate is, in its effect, purely an export bounty.

Whether or not an import turnover tax is levied, a general sales or turnover tax tends to discriminate against domestic import houses which are in competition with tax-free foreign exporters. This discrimination against domestic importers can be relieved by exempting the sales of such concerns from the domestic turnover tax.

CHAPTER VI

LUXURY TURNOVER TAXES

AS WAS established in Chapter I,¹ a general sales or turnover tax tends to absorb a larger proportion of the income of the lower-income classes of the population than of the higher-income classes. This generally recognized characteristic of a general sales or turnover tax proves a political stumbling block in the way of the enactment of such taxes. This tendency may be offset by elements in other parts of a national or state tax system bearing more heavily on the richer classes, or it may be reduced, if not eliminated, by the exemption of the necessities of life from the operation of the tax; these circumstances were considered in detail in Chapter I.² The third possibility of softening or eliminating the undesirable social effects of a general sales or turnover tax is the levy of a supplementary luxury tax. All foreign countries having turnover taxes, except Canada, Cuba, Italy³ and Poland, have at one time or another combined supplementary luxury turnover taxes with their other turnover taxes.

ECONOMIC AND SOCIAL CONSIDERATIONS

The efficacy of a luxury turnover tax offsetting or counterbalancing the tendency of a general sales or turnover tax to burden the poorer classes more heavily depends primarily on (1) the scope of such a luxury turnover tax, (2) its rate schedule, and (3) its incidence. These three factors are considered in this section. The conditioning effects of the administration of the tax and the efficiency of its collection are reserved for subsequent discussion.

Scope of Luxury Turnover Taxes

The scope of a luxury turnover tax would depend upon the definition which legislators placed upon the term "luxury."

¹ See p. 39 of this volume.

² See pp. 40, 42-44 of this volume.

³ The high rates on the sales of a very limited category of luxury articles in Italy are effected through rate discriminations in that country's general sales or turnover tax, and not through a supplementary luxury turnover tax.

This definition necessarily must be arbitrary, for the concept of "luxury" is too confused with moral elements to be reliable as an economic or fiscal standard. The dictionary definitions of "luxury" draw in such attributes as "extravagance," "indulgence," "wantonness," "excess." Economists, when they deal with the subject, veer into the ethical issues involved in the distribution of income. As one writer on the subject of luxury taxation complains in despair, "The concept of luxury is an irrational one and clashes with the sober word tax."¹

Suppose that the concept of "luxury" is so broadened that it covers all "non-necessities," and a tax is levied on the basis of this concept. Then it must largely fail of its initial purpose of counterbalancing the tendency of the general sales or turnover tax to overburden the poorer classes, since it will extend to many of the articles purchased by the lower-income classes, particularly if they have achieved, as in the United States, a standard of living including a moderate margin of comfort. If the "poorest poor," living at the minimum of existence, be excluded from consideration, it may safely be said that the purchase of automobiles, radio sets and silk stockings takes relatively more of the income of the lower-income classes than of the higher-income classes. A luxury tax levied on the sale of automobiles, of silk stockings and of radio sets, instead of compensating for the excess burden which a general sales or turnover tax lays on the poorer classes, might itself augment this tendency.

If the concept of luxury be restricted to "obviously luxury" articles, such as jewelry and works of art, the actual burden of the tax bearing on the well-to-do classes would be so slight as to constitute no serious counterbalance to the basic general sales or turnover tax. Moreover, a luxury turnover tax of such restricted scope would rest on the luxuries of culture and omit the luxuries of fashion,² an undesired and undesirable result.

Those countries that have taken their luxury turnover

¹ Eleanore Lusensky, "Die Luxusumsatzsteuer in Deutschland," *Münchener Volkswirtschaftliche Studien*, n. f. 3, p. 58.

² Grete Auerbach, "Die Luxusumsatzsteuer," *Zeitschrift für die gesamte Staatswissenschaft*, 1921, p. 137.

taxes seriously have determined the scope of such taxes by an empirical, not a logical, compromise of political, social and administrative factors. The German lawmakers frankly approached their problem by defining the scope of their luxury turnover tax (first levied in 1918 and abolished because of administrative collapse in 1926) as including those articles purchased by the well-to-do classes and not purchased by the poor.¹ Most of the other countries that have levied luxury turnover taxes supplementary to commodity transfer taxes or general turnover taxes have tacitly embodied this concept of "luxury" in the scope of their taxes.

The scope of a luxury turnover tax may be determined by two standards—by a list of articles specifically indicated as luxury articles, and by setting price limits for various articles and applying the luxury tax to those that cost above the set prices. The first standard was applied in Germany until 1926. The second standard is applied in part in the French and Belgian turnover taxes.

Specific Listing of Taxable Luxury Articles

The German tax authorities and legislators gave thought to the possibility of basing a part, at least, of their luxury turnover tax on the prices charged for articles, the higher-priced articles to be taxable luxuries and the lower-priced articles to be deemed non-luxuries, but the rapid changes of price levels at the time the tax was under consideration persuaded them to forego this possible basis. Instead, they prepared two lists of articles to be taxed as luxuries. The first included "obviously luxury" articles, such as feather boas, jewelry, fans and so forth; fifteen classes of such "obviously luxury" articles were listed under the "producers' luxury tax" and a corresponding list under the "retail luxury tax." The second list included items of general consumption which embodied special qualities, such as mahogany furniture distinguished from furniture made of inferior woods; thirty-two classes of articles in this second category were listed for the "producers' luxury tax."

It might be thought that the first category of taxable luxuries, "obviously luxury" articles, would present few

¹ Lusensky, *op. cit.*, p. 20.

difficulties. Nevertheless, the German tax authorities found themselves immediately faced with the problem of cheap imitations of expensive articles. Should the luxury tax be applied to the cheap imitation jewelry with which the servant girl adorned herself? If not, where along the scale of jewelry values should the dividing line be drawn? The administrators of the tax law sought to allay this difficulty by the application of rule-of-thumb criteria, but no broad satisfactory solution had been evolved by the time the tax was abolished in 1926.

The attempt to draw a valid dividing line between the articles in the second list and corresponding non-taxable non-luxury items proved a source of endless confusion and conflict. Five major criteria were applied: (1) the substance or material of the object (in some cases the determining element was whether the substance of the article was the result of a mechanical or of a chemical process); (2) the character of the work upon it; (3) the size of the article; (4) the artistic effort spent upon it; and (5) the use to which the article was put.¹ The application of some of these criteria produced absurdities; a doll under sixty-five centimeters in length was not deemed a luxury, for example, while a doll a few millimeters larger was taxable. The application of the fifth criterion left broad loopholes for evasion; automobiles used for business purposes were not subject to the tax, with the result that all purchasers of automobiles claimed that these were being bought for business use, and practically no revenue was obtained in Germany from the taxation of automobiles as luxuries.

The list of articles taxable as luxuries was honeycombed with exceptions and with exceptions to exceptions. Perfect consistency was impossible, and the hit-or-miss character of many parts of the list resulted in heavy taxation of certain articles while almost identical ones, or very close substitutes, went untaxed. Many producers and retailers were faced with the necessity of determining which of their sales products overstepped the hair-line distinctions of the law, thereby becoming taxable luxuries, and which were in the non-taxable categories. They were compelled to set up

¹ *Ibid.*, p. 24.

artificial systems of accounts to cover the distinction. The administrative authorities had the unpleasant and burdensome responsibility of creating tax liabilities on the basis of arbitrary classifications.

Reduction of the rate of the German luxury turnover tax in 1925 lessened the burden of its discriminations, but did not simplify them. Dissatisfaction was widespread, and the tax authorities saw no way out of the maze. The tax was abolished in 1926. The thorough experimental test of the system of the specific listing of luxury articles, which is offered by German experience with the tax from 1918 to 1926, may be taken to establish conclusively the impracticability of this method of setting the scope of a luxury turnover tax.

The Price Standard

France and Belgium, like Germany, made a group of "obviously luxury" articles the nucleus of their lists of taxable luxuries. Instead of proceeding to enumerate a second list of articles of special quality taxable as luxuries, the French and Belgian tax authorities drew up a list of general classes of consumption items, with prices set against each class. If an article within the class was under the set price, it paid no luxury tax. If it exceeded the set price, it was a taxable luxury. Thus the Belgian 1927 law, under the category of time-pieces, provided that watches costing less than fr. 200 would not be subject to any luxury tax, while those costing between fr. 200 and fr. 1,000 would pay the 6% luxury tax and those costing over fr. 1,000 would pay the 10% tax; that clocks would be subject to the 10% tax if their price exceeded fr. 400, and that alarm clocks would be subject to the 6% tax if their price exceeded fr. 75.

While the price standard for determining luxuries avoided many of the arbitrary features of the German system of specific listing, it involved capricious elements of its own. The price limits set for individual articles could never be other than arbitrary. One charge against the German system of specific listing was that it caused manufacturers to revise their standards of production so as to escape the specifications of the luxury tax law, without regard for the

inferior quality that might result. Against this must be set the charge that the French and Belgian producers in many cases revised downward the quality of their production so that they could charge prices under those set by the luxury tax laws and so escape the tax. Moreover, the practice developed of making and selling luxury articles in parts, each part of which would cost less than the set price, and thus avoiding the tax entirely, although the value of the whole article, when assembled, might be considerably in excess of the set price.

The major difficulty of the system of set prices, the difficulty that persuaded the German legislators to forego the system in 1918 and attempt the method of specific listing, is the changing of price levels. This problem was, of course, much more vital during the first half of the decade following the war than at present. As the general price level rises, or as the price rises for any group or class of articles for which price limits have been set under a luxury turnover tax, the tax is extended to articles of lower and lower quality. If frequent revisions of the price limits are not made, the tax in a short time becomes a burden on the purchases of the poorer classes. In a period of relatively stabilized prices, this objection loses its force.

Articles Utilized in Business

It sometimes occurs that articles which would be luxuries if purchased by individuals are necessities when utilized in business enterprise. A bicycle purchased for the amusement and exercise of a boy may be fairly classified as a luxury; it is a necessity to a telegraph messenger. Also, items which purchased individually are luxuries may lose part or all of their luxury character when they are amalgamated with a greater whole. To place a parquet flooring in a house already constructed may be deemed a luxury expenditure; such flooring included in the construction of a new dwelling house may well be viewed as a minor item in the creation of an article—a dwelling house—of a non-luxury character.

The German and the Austrian tax laws, among others, sought to draw these distinctions. The results were not happy. Purchasers of luxury articles convinced themselves

and sought to convince the tax officials that their purchases were for business use.¹ The German tax law endeavored to draw a more strict line; it provided that the incidental business use of a luxury commonly purchased by individuals would not serve to place it in the exempt class. Even so, broad loopholes were allowed for evasion. The German luxury tax on the sale of automobiles, as was pointed out, collapsed completely because all purchasers asserted that their cars were to be used for business purposes, and there was no practicable method of disproving their claims.

Granting that a luxury turnover tax fails of its purpose and perpetrates a definite injustice when it burdens business or industry, the attempt to remedy this abuse by a series of exemptions weakens the administrative structure of the tax. This dilemma constitutes one of the inherent weaknesses of the luxury turnover tax.

Guest Service Taxes

With the exception of Austria, the European countries at present levying luxury taxes include guest service in hotels and restaurants within the scope of these taxes. The German luxury turnover tax, levied from 1918 to 1926, was unaccompanied by a special guest service tax. All of these guest service taxes cover restaurant service and, except in Russia, Hungary and Luxemburg, they cover the renting of hotel rooms and lodgings. In all cases these guest service taxes are levied independently of, and complementary to, the more general luxury turnover taxes.

In a few instances the guest service tax is levied at a single flat rate, as in Hungary. More commonly, the restaurants and dining-places covered by the tax are classified, either on the basis of the prices charged or on some other arbitrary basis, and graduated rates are levied. Thus, in France three rates are levied; establishments of the highest class pay 13% on their turnover, establishments of the second class pay 4%, and all others are taxed at the 2% rate of the general turnover tax. The classification of hotel and rooming establishments may be made either upon the basis of the prices charged, as in France, or, more com-

¹ *Ibid.*, pp. 22-23.

monly, by the character of the establishments' furnishings and the service rendered.

THE RATE SCHEDULES OF LUXURY TURNOVER TAXES

At its broadest, the scope of a luxury turnover tax is far narrower than the scope of any general sales or turnover tax it might supplement. If it is to be at all effective in counterbalancing the regression of such general sales or turnover tax, its rates must be heavy. Moreover, the total burden of a multiple-turnover tax on any article represents a pyramiding of the rate of the tax (unless there has been a consolidation of the pyramided tax), so that the final burden of the tax may be considerably higher than its rate alone would indicate.¹ The luxury turnover tax, however, is always levied as a single-turnover tax (except in Russia). This provides a second reason for high rates in luxury turnover taxation. Furthermore, the fiscal factor can not be overlooked; the higher the rate, the greater the revenue from the tax. Social and political arguments likewise favor high rates.

From 1920 to 1924 the German luxury turnover tax was levied at a 15% rate. The rate of the French luxury turnover tax, originally 10%, was raised in 1924 to 12%. The rate of the Austrian tax has always been 10%. The Czechoslovakian luxury tax is at a 10% rate when collected from producers and at a 12% rate when collected from retailers or when charged on an incidental sale by an individual. Under the Roumanian tax, luxuries are given a threefold classification and taxed at 20%, 15% and 10%.

THE INCIDENCE OF LUXURY TURNOVER TAXES

Let it be assumed that the scope of a luxury turnover tax has been so adjusted that it includes all articles purchased by the well-to-do classes and not purchased by the poor. Let it also be assumed that the rate or rates are high enough so that, if the tax is fully shifted, it will constitute sufficient of a burden on the well-to-do classes to offset the regressive character of the general sales or turnover taxes which it

¹ See p. 118 of this volume.

supplements, provided that it is shifted to them and actually constitutes a burden on them. The question arises, is this tax burden shifted to the purchasers of the taxed luxury articles, or does it remain a burden on the sellers?

As was pointed out in Chapter I,¹ the possibility of shifting from seller to purchaser a tax placing discriminating burdens on particular commodities or services depends on the relative elasticities of the demand for the taxed articles and of their supply. To the extent that the demand for the taxed articles is inelastic and the supply is elastic, the tax tends to be shifted. To the extent that the demand is elastic and the supply inelastic, the tax tends to remain a burden on the seller.

The demand for articles subject to luxury turnover taxation comes from two classes—the middle classes and the rich classes. Where the price and character of an article are such that it is purchased by both of these classes, the consumption demand of the middle classes is likely to be highly elastic, while the consumption demand on the part of the rich classes is much less elastic because of the possibility of satiation.² Because the volume of the purchasing demand of the middle classes tends to outweigh the purchasing demand of the numerically fewer richer classes, the character of the demand by the middle classes is likely to impress itself upon the demand for the commodity or article as a whole.

There is a strong probability of elasticity in the consumption demand of commodities purchased by both the middle and rich classes. Even in the case of articles whose purchase is confined exclusively to the rich classes because of their extreme prices, there may be some element of elasticity, though the element of "conspicuous" expenditure as a means of obtaining or retaining social distinction is very strong in this type of consumption demand and tends towards inelasticity.³ If we take all classes of luxury consumption into consideration, however, a strong strain of elasticity in the consumption demand for luxury articles must be granted.

¹ See p. 20 of this volume.

² Alfred Marshall, "Principles of Economics," seventh edition, London, 1916, pp. 105-106.

³ *Ibid.*, p. 106.

On the production side of such articles, an element of inelasticity asserts itself. The production of luxury articles is likely to be specialized, to involve artistic skill or technique not readily transferable to other, lower-taxed, lines of production. Producers of luxury articles are not organized to reduce their production so as to diminish the supply and thus maintain their prices irrespective of any tax imposed.

The element of elasticity in the consumption demand of luxury articles, coupled with inelasticity in the production and supply of such articles, raises the possibility that luxury turnover taxes may not always be shifted to, and be borne by, the purchasers of luxury articles—the well-to-do classes, which such taxes are intended to burden. It is possible, even probable, that in many instances a luxury turnover tax rests either on the producer of luxury articles, or on the vendor, or is spread between them. Such a situation doubly contravenes the purpose of a luxury turnover tax. It places an excessive, almost annihilative burden on certain producing and merchandizing groups. It imposes no special burden on the well-to-do classes to offset the contrary tendency of a general sales or turnover tax. The very elements of broad scope and high rates, essential to the social purpose of a luxury turnover tax if it is shifted in its entirety, become the instruments of special injustice and discrimination in cases where it fails of being shifted.

ADMINISTRATIVE CONSIDERATIONS

One of the major arguments in favor of a general sales or turnover tax is the relative simplicity of accounts which it entails, and the consequent ease of burden it imposes on the administrative authorities. No such simplicity of accounts or administration is present for the luxury turnover tax. In fact, the difficulty of its administration is one of the most serious objections to it.

Dealers' Luxury Turnover Tax

When a luxury turnover tax is imposed on the retail sales of the selected articles by dealers, the broader the scope of the tax, the more dealers will be involved in its collection.

If its scope is of sufficient breadth to make it an effective counterbalance to a regressive general sales or turnover tax, the number of dealers called upon to make returns will be almost as great as would be involved in the collection of a general retail sales tax. The cost of collection for a luxury tax would be much greater, however, because the revenue per return would be less than in the case of a general retail sales tax.

A second factor augmenting the administrative difficulty of a luxury turnover tax is the complexity of accounting imposed upon dealers who must charge the tax in their prices and pay it to the government. Each dealer must determine which articles sold by him are subject to the luxury turnover tax and which are not—by no means a simple problem under the German system of specific listing or even under the French system of set prices. Each dealer must keep track of changes in the listing or set prices, or he may find that, after having sold an article without inclusion of the tax in his price, he is liable to the government for a tax on it. Sales may not be set up generally in account books; they must be divided into two main categories, taxable and non-taxable, and so posted. If the tax is levied at several rates, the dealers' labor of including the tax in their prices and of accounting for it to the government is correspondingly increased. In all countries where luxury turnover taxes have been levied, the dealers chargeable with the tax have protested against the additional, heavy, uncompensated labor imposed upon them.

Finally, the large number of dealers who must report under a luxury turnover tax and the complexity of accounting imposed upon them, create a difficult task for the tax administration. This task is enhanced by the opportunity for evasion of such a tax. How is it possible to determine for thousands of dealers whether each one has reported all of his taxable luxury sales? Suppose that the dealer and the customer are in collusion, and the tax is not charged. The dealer can camouflage his books and successfully cover up the deal. Unless the cost of administering the tax is to be made so heavy as to consume the greater part of the revenue from it, enforcement must be largely hit-or-miss and must

depend upon heavy punishments for chance discoveries of fraud.

Producers' Luxury Turnover Tax

If the producer of luxury articles could be made responsible for charging and collecting the luxury turnover tax, the problem of administration would be greatly simplified. The producers of luxury articles are fewer in number than the dealers in them, and the number of returns to be handled would be considerably reduced. Moreover, each producer is likely to specialize in a few lines or articles. He need keep track of specifications and price limits only with regard to these articles. Moreover, the producer is more likely than the retail dealer to keep his accounts in a form adaptable to the tax levy.

Not all luxury articles, however, can be pinned to specific producers. A watch of expensive make, for example, after leaving the manufacturers apparently a finished product, may have valuable jewels set in the case or may have its case engraved before final sale. If the luxury tax were levied exclusively on the manufacturer, the subsequent processes increasing the watch's value would escape taxation. There is less standardization in luxury articles than in commodities of common consumption. Consequently, there is little possibility of successfully fixing on particular producers' processes to cover full tax liability.

The compromise solution arrived at by most countries that have enacted luxury turnover taxes is to levy as much of the tax as is practicable in the form of a producers' luxury tax, covering the remainder by a retailers' luxury tax (exempting the articles taxed to the producers from the retailers' tax). This compromise, while it eases the general problem of administration, creates special difficulties of its own. Unless extreme care is taken to make the two taxes fully complementary, there is the possibility that particular items may escape taxation altogether. In guarding against this possibility of escape there is danger that some articles may be caught under both taxes.

Steering a middle course between these two dangers may involve the introduction of further minute complexities into

the tax schedule. For example, under the German producers' luxury tax, watches were taxed to the producer. If a band of tooled leather or of precious metal were subsequently attached to the watch and it were sold as a wrist-watch, a large element of luxury value would escape taxation. Therefore wrist-watches, watch and band, were made specially taxable to the retailer. Now double taxation of the value of the watch was involved. Therefore, the law provided that small watches (intended to be used as wrist-watches) should be exempted from the producers' tax when they were not provided with clasps for receiving a band (since they could not then be sold separately from the band and so were sure to come under the retailers' tax). Thus retailers paid no taxes on watches other than wrist-watches sold by them; if the wrist-watches in their stock had clasps to receive bands, so that the customer might attach watch and band, they sold watch and band separately, charging the luxury tax on the sale of the band only; if there were no clasps to receive a band, so that the retailer himself had to attach the band by soldering, or otherwise, before selling the wrist-watch, the combined watch and band were both taxable. By such provisions, escape from taxation was checked without involving double taxation, but only at the cost of circuitousness and confusion.

CONCLUSIONS

By whatever method levied, a luxury tax is cumbersome and expensive to administer, and is often provocative of a multitude of incidental, individual injustices. At best, what with problems of scope and widespread evasion, its yield is small. At the period of its greatest relative yield, in the fiscal year ended March, 1925, the German luxury turnover tax produced only 6.2% of the total yield of the combined German turnover taxes. The French luxury tax has an annual yield of approximately fr. 20 millions, while the French commodity transfer tax produced fr. 9,262 millions in 1928.

In view of its administrative difficulties, its high cost of collection, the uncertainty of its being uniformly shifted to purchasers and its low revenue yield, the luxury turnover tax has proved to be a social makeshift rather than a valid

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revenue tax. It has political value because of its appearance of sharp progressivity; from the fiscal point of view, it is more often productive of trouble than of revenue. An English parliamentary commission studied the possibilities of a luxury turnover tax for England to be levied independently of any other form of general sales or turnover tax, and reported that the tax was incapable of successful levy.¹ The German luxury turnover tax, after eight years of attempted enforcement, was abolished in 1926.

¹ Auerbach, *op. cit.*, p. 136.

CHAPTER VII

SUMMARY

THE advisability of levying a general sales or turnover tax has been debated in several state legislatures during recent sessions. It is possible, even probable, that the next few years will see some states enact this form of tax.

The history of the general sales or turnover tax extends through the Middle Ages and to antiquity. Only within the past decade, however, has it been given a general place in tax systems. Within the space of a few years it has developed from a subject of classroom discussion to a major source of tax revenue for many countries. Only England and the United States, of the greater national states, have been reluctant to employ it.

In the United States, neither the Federal Government nor most of the state governments make present use of the general sales or turnover tax in their tax systems. Whether or not the Federal Government or the state and local governments should levy such a tax in the future depends upon the constitutional, the economic, the administrative and the revenue characteristics of the tax.

POSSIBILITIES OF FEDERAL TURNOVER TAXATION

Under the United States federal system of government, many taxes may be levied by either the Federal Government or by the state and local governments, or by both concurrently. The general sales or turnover tax is one of these taxes. Different considerations govern, however, according to whether such a tax is levied by the Federal Government or by the state or local governments. It is, therefore, advisable to consider the two cases separately.

Constitutional Considerations

Few constitutional restrictions are placed on the federal powers of taxation, and these few would not prevent the

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levying of a general sales or turnover tax. The Federal Government could make such a levy as a tax on the privilege or act of doing business; or, more narrowly, as a tax on the act of manufacturing and extractive production; or finally, as a tax in the nature of an excise on sales transactions in general or on some particular aspect of the sales transaction.

Constitutional obstacles might arise if it were desired to extend a turnover tax collected from the seller to the export or import of goods and commodities. The taxation of the act of exportation is specifically forbidden by the Federal Constitution. Importation may be freely taxed, but the seller of the commodities, who would be liable under a federal turnover tax, could not be reached by the tax law because of his foreign residence. For economic reasons, however, it would be inexpedient to tax the act of exportation under a general sales or turnover tax, so that the constitutional difficulty here is not important. The act of importation could always be reached by a separate, supplementary import turnover duty collected on the occasion of the entry of the goods into the country.

Economic Considerations

The tendency of a general sales or turnover tax levied by the Federal Government would be to raise by the amount of the tax the prices of most articles purchased by consumers. By reducing consumers' purchasing power, a general sales or turnover tax would redistribute consumers' demand, in general decreasing the demand for various luxuries and non-essentials. In the long run, this decrease in the demand of these luxuries would lead to a corresponding contraction of their supply. To what extent this change would result in increased prices for these luxuries would depend upon the circumstances of their production. This general rule must be qualified by several particular exceptions.

For a period after the imposition of a general sales or turnover tax, while consumers' demand in affected luxury lines was decreasing, the producers of these articles might seek to maintain their markets by retaining their original prices, despite the tax, or even by cutting the price. During this period of adjustment, until supply and demand in the af-

fectured lines had found a new price equilibrium, the producers and dealers of these articles would probably suffer reduced profits or outright losses.

If a general sales or turnover tax were levied during a period of economic depression, when demand was dull and prices were perhaps declining, producers and dealers might find it impossible to add the tax to their prices without further checking purchases, and the tax would fall upon them, possibly adding to their losses. Conversely, during a boom period when producers and dealers were grasping at all excuses to increase their prices, the imposition of a general sales or turnover tax might result in price increases larger than the tax paid by the producers and dealers. Both of these phenomena, it should be realized, would be temporary in their nature.

Many articles are marketed at standard prices, so rigid that they will withstand even broad fluctuations in the general price level. A tax levied on their production and sale, particularly if the amount of the tax were small in proportion to their prices, could not conveniently be added to these prices, but for a time, at least, would be absorbed by the producers and dealers as a reduction of their profits. In the long run, it is probable that adjustments in the quantity or quality sold at the fixed price would take the tax into account.

A multiple-turnover tax—one that is levied on an article more than once in its progress from initial producer to consumer—would tend to discriminate between articles as to the proportion of the pyramided tax to the retail selling price. These discriminations would tend to reduce consumers' demand for those articles burdened more than the average and to increase it for those burdened less than the average. Over a short period of time the differences in tax burdens on various commodities would be likely to result either in losses or special profits to producers and dealers. In the long run, a new market equilibrium would be set up, but whether the new prices were higher or lower by the exact amount of the tax discrimination, or whether they exceeded or fell short of this figure, would depend on the relative elasticities of the demand and of the supply of each com-

modity involved in the discrimination. This problem would not arise with the retail sales tax, by which all articles bear a tax burden proportional to their retail sales price.

As to producers, a multiple-turnover tax would naturally tend to place a discriminatory tax burden on series of independent-process concerns which compete with multiple-process concerns combining many productive and distributive processes. The latter would pay only a single tax on their output. The output of the former would be taxed a number of times, since a sale would mark each process. The Austrian system of consolidating the pyramided tax on each article to a single rate, to be paid alike by the multiple-process concern and by the series of independent-process concerns, would probably be inapplicable to a turnover tax in the United States because of the administrative complexity it would introduce, though there are possibilities in its employment for a limited list of standardized articles. The effect of this discrimination would be to throw a special unshiftable tax burden on independent-process concerns, reducing their profits, and adding a further inducement to industrial and distributive consolidations. This problem would not arise in the case of single-turnover taxes, such as the production tax or the retail sales tax.

Social Considerations

Since the general tendency of a general sales or turnover tax would be to increase the prices of all goods purchased by consumers by approximately the amount of the tax, it might be viewed as a tax on, or proportioned to, consumption. The consumption expenditures of the poorer classes absorb a larger part of their income than do the consumption expenditures of the richer classes. Moreover, a larger proportion of the expenditures of the richer classes are for services, which are not taxed under many forms of the general sales or turnover tax. Therefore, in proportion to income, a general sales or turnover tax would bear more heavily on the poorer classes than on the richer classes.

This tendency of a general sales or turnover tax runs counter to currently accepted political and social beliefs. From a political point of view, this circumstance limits the

application of the tax. A federal general sales or turnover tax, standing by itself, would probably fail to obtain legislative support because of its social effects. Combined with some other tax, such as a graduated personal income tax with large exemptions, which imposes heavy burdens on the rich classes, and light burdens, or no burden at all, on the poor classes, it might find support. The social expediency of a federal turnover tax would depend on the complexion of the rest of the federal tax system.

The burden of a general sales or turnover tax upon the poorer classes might be lessened in two ways. A luxury turnover tax might be levied on the production or retail sale of articles purchased exclusively by the rich. If the scope of such a supplementary luxury tax were broad enough, if its rates were heavy enough, and if it were certain to be shifted in its entirety to wealthy consumers, such a supplementary tax might radically alter the social character of a general sales or turnover tax. The luxury turnover tax, however, has in several cases proved administratively impracticable, and, in addition, there are serious doubts that its burden actually falls in any large part on the wealthy consumers it is intended to reach.

An alternative method of lightening the burden of a general sales or turnover tax on the poorer classes would be to exempt the sale of foodstuffs and other necessities of life from the operation of the tax, or at least to tax them at a special low rate. Purchases of these necessities represent a larger proportion of the consumption expenditures of the poor classes than of the rich. Consequently, the exemption would be a major benefit to the poor classes, but would have only a minor effect upon the rich. Against the social benefit of such an exemption, however, must be weighed the administrative disadvantages which it would entail.

Administrative Considerations

A federal general turnover tax with a uniform rate applied to all sales made and all services performed in regular lines of business would be the least difficult of all forms of federal turnover taxes to administer, except for the problem of a multiplicity of small returns. Since every type of business

activity would come under it, there would be no problem of hairline exemptions or exceptions. Since all commodities and services would be subject to the tax, taxpayers would not be induced to juggle their accounts so that taxable sales would appear in the non-taxable list. Keeping a record of total sales would not impose a special accounting burden on most taxpayers, and it would be an item easy for the administration to check in most cases.

Any and every divergence from this uniform type of tax would add to the burden of administration and would open possibilities of avoidance and evasion. A commodity transfer tax, not extended to the performance of services, would raise the question of when a sale involved a commodity or article and when it covered the performance of a business service. Where doubt existed, taxpayers might claim that they sold services, not articles, and the administration would have to be ever on the alert to prevent such escape. A production tax, intended to be levied on all commodities once and once only in the course of their production, would involve a complicated system of licensing producers and dealers, and would impose upon them a heavy burden of accounting. A retail sales tax would necessitate a constant check to reach wholesalers and manufacturers who made retail as well as wholesale sales.

Exceptions or exemptions as to commodities subject to the tax would produce administrative difficulties of a different order, but no less serious. If necessities, or any other category of articles, were exempted, each producer and dealer would have to keep a double set of accounts, one for taxable sales, the other for non-taxable transactions. Deliberate or unintentional misclassification of sales as between the taxable and non-taxable groups would be very difficult for the administration to detect or to prove. An open invitation would thus be given to fraud.

A general sales or turnover tax, like any other tax with a broad base, would raise the question of a multiplicity of returns from small manufacturers and dealers, covering tax payments of such small amounts that filing and checking them would cost more than the revenue received. A small minimum exemption, from \$1,000 to \$5,000, according to the

rate of the tax, would eliminate a large proportion of these returns. Such an exemption, however, would offer an opportunity for evasion, since many producers and dealers would fail to make returns, and, with no record of their existence, it would be difficult, if not impossible, to bring their evasion to light. If, instead of being allowed an outright exemption, they were required to report their existence and accompany the report with a minimum flat tax, \$10 or \$25, according to the rate of the tax and the minimum turnover to be reported, the administrative problem would be simplified.

Revenue Considerations

At the present time (1929) the Federal Government is not seeking new sources of tax revenue. Instead, there is still talk of further reductions of the rates of the existing federal taxes. There is little probability of adding a general sales or turnover tax to the present federal tax system. Political considerations and the administrative inadvisability of substituting a new untried tax for one already established and accepted, oppose the levying of a general sales or turnover tax in place of one of the present federal taxes.

It is not inconceivable, however, that in the future the Federal Government may find that it requires more tax revenue than the existing tax system can raise. In such case, a federal general sales or turnover tax would not be beyond consideration.

The yield of a federal general sales or turnover tax would depend on the economic circumstances of the country, on the scope of the tax, and on its rate. In 1921, estimates of the yield of a 1% federal commodity transfer tax ranged between \$1,700 millions and \$6,720 millions, the lower estimates probably being the more accurate. It was calculated at the time that a federal production tax would give \$759 millions.

POSSIBILITIES OF STATE AND LOCAL TURNOVER TAXATION

Many of the factors considered in connection with the levy of a general sales or turnover tax by the Federal Government apply with equal force to the levy of such taxes by the

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state and local governments. Certain issues, peculiar to state and local turnover taxation, however, deserve special notice.

Constitutional Considerations

Specific or implied limitations of the Federal Constitution restrict the powers of the state and local governments to levy general sales or turnover taxes. The federal courts are strict in their application of these limitations.

A production tax can be levied by a state or city without conflicting with any federal constitutional limitations, the taxable value of the goods being determined by their sales price, irrespective of whether the goods are subsequently sold to customers within or outside the taxing state. If a state or local turnover tax is levied as a tax on the privilege or act of doing business, and if the attempt is made to collect the tax on sales made to customers located outside the taxing state, the tax is unconstitutional as interfering with interstate commerce. The states and cities at present levying turnover taxes on business enterprise avoid this difficulty by levying the tax on manufacturers and extractive enterprise as a tax on the act of production, and by limiting the tax on merchants to their intrastate sales. It is possible that the sales of merchants to customers located outside the state might be brought under the tax if, instead of collecting it on their sales, the tax were collected on the value of the goods held in stock for sale.

No state or city has yet deliberately levied a general sales or turnover tax upon the act of sale as such. A turnover tax of this type might be held to be interference with interstate commerce and hence unconstitutional. If the tax statute were so worded, however, that the tax was levied on the transfer of title of the goods sold, and the amount of the tax was measured by the value of the goods at this transfer of title, there is a possibility that the tax might be upheld by the courts.

Of course, any state or local turnover tax would have to conform with the provisions of the state constitution under which it was levied, but most state constitutions would not present any bar to the levy of such a tax.

Economic Considerations

If a state or city levied any other form of general sales or turnover tax than a retail sales tax, there is a strong probability that it would not be entirely shifted. Types of industrial or business enterprise such as wholesale merchandizing, which have large turnovers in proportion to invested capital, would find themselves in competition with lower-taxed rivals in other states and would have to absorb the tax themselves. The setting of lower tax rates for such types of enterprise, as is done in the West Virginia tax, would relieve this discrimination.

Moreover, individual concerns in all lines with turnovers relatively larger than the average would also find that they bore a heavier tax burden than their competitors in states or cities which do not levy turnover taxes. Such concerns would have to bear the difference in tax burdens as a reduction of their profits. There appears to be no practicable means by which this discrimination of a state or city turnover tax can be avoided.

Social Considerations

That a state or city turnover tax is not shifted as consistently as is a federal turnover tax does not seriously modify its social aspect. A state or city turnover tax also bears more heavily on the poorer classes than on the rich. It is frequently held that the state and local tax systems as a whole have a marked tendency in this direction already. The superimposition of state or local turnover taxes without any modifying adjustments would probably exaggerate this tendency. For this reason the levy of a state or local turnover tax should probably be coupled with the levy of other taxes, such as a personal income tax with graduated rates, whose effect would be to offset the discrimination of a general sales or turnover tax against the poorer classes. Another application of the turnover tax which might find popular support would be the use of it as a substitute, wholly or in part, for other state or local taxes whose social effects are similar to those of the turnover tax but which suffer from greater administrative disadvantages.

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Administrative Considerations

Except in the cases of production taxes or retail sales taxes, state or city turnover taxes involve certain discriminations, introduced for economic or legal reasons, which magnify their administrative problems. Because there is a strong probability that state or city turnover taxes bearing on wholesale merchandizing will not be completely shifted, it is common to fix a lower rate on such enterprise than on manufacturing or retail merchandizing. In many cases the distinction between manufacturing and wholesale merchandizing, or between wholesale and retail trade, is very fine. The taxpayers, of course, are alert to give themselves the benefit of any doubt. The administration is called upon for additional activity to keep this avenue of evasion closed.

Because of the limitations of the Federal Constitution, certain kinds of state or city turnover taxes can not be extended to sales made by merchants to customers residing outside of the state or taxing jurisdiction. Such merchants must classify their sales in the two categories of taxable intrastate sales and non-taxable interstate sales. They report and are taxed on the former only. The opportunity given for concealing taxable sales among the non-taxable sales necessitates an additional amount of administrative supervision.

Revenue Considerations

The revenue possibilities of the tax are indicated by the yield of the West Virginia Business Occupation Tax, which, despite an excessively large exemption, produced more than four million dollars of revenue in the fiscal year 1926-1927, or nearly one-fourth of the total tax revenue of the state. The pressure of expenditures and outlays on existing state and local revenue systems is a serious problem in many states. It is possible that, its practicability assured and due allowance being made for the social distribution of its general burden, the states, and possibly city governments, will turn in growing numbers to the general sales tax as a fresh source of revenue.

APPENDICES

APPENDIX I

FOREIGN GENERAL SALES OR TURNOVER TAXES

The pressure of financing during the World War and the post-war years compelled the European countries, particularly the belligerent powers, to strain their revenue resources to the uttermost. The general sales or turnover tax was hailed by the hard pressed treasuries of these countries as an avenue of salvation. Germany and France levied turnover taxes during the war years. All the major European countries except England, and a large proportion of the smaller states, have resorted to general sales or turnover taxes in the succeeding years; some of these turnover taxes were repealed after short trial, but most have continued in force down to the present time. General or partial turnover taxes have been continued or recently enacted in several of the Latin American countries and in Canada. With few exceptions the foreign general sales or turnover taxes in force today are less than a decade old.

Although the present practice of general sales or turnover taxation is relatively novel, the principle has a long history behind it. This early experience was heavily drawn upon in the arguments for and against the modern taxes, and it was not without influence upon their forms and characteristics.

TURNOVER TAXES PRIOR TO THE WORLD WAR

Among their many and interesting fiscal experiments, the ancient Greek and Roman civilizations tried rudimentary forms of turnover taxation. Feudal exactions comparable in form and effect with general sales or turnover taxes were prevalent throughout the Middle Ages. Turnover taxes became a major element in the early Spanish and French national states. Sporadic examples appeared in the Nineteenth Century.

Ancient General Sales or Turnover Taxes

Market transfer taxes, with rates differentiated according to the commodities sold, existed in many of the Greek city-states; since practically all retail sales were transacted at these city markets, these taxes had the effect of retail sales taxes. To provide funds for the protection of commerce, an important function of the Greek city-states, heavy transfer taxes were levied on the sales of wholesale merchants. It is not probable that these two sets of taxes were considered as forming a system of general sales taxation.¹ Their effect, however, was in this direction. With the political and commercial collapse of the Greek city-states, these turnover taxes disappeared; at least, there is no record of their later collection.

¹ Grabower, "Geschichte der Umsatzsteuer," pp. 17-33.

The Emperor Augustus instituted a 1% Roman turnover tax in 9 A.D., under the name *centesima rerum venalium*, to cover his heavy military expenditures.¹ The tax probably applied only to goods sold at auction, but this was the customary Roman method of marketing all commodities except articles of domestic consumption, so that the tax was broad in its application. In the year 17 A.D. the Emperor Tiberius reduced the rate one-half. The 1% rate was later restored and still later doubled.

Records of the continuation of the tax are fragmentary. It was still levied during the reign of Nero. The same or a similar tax was collected under the Emperor Constantine and passed into the tax system of the Byzantine Empire, where it was employed by the Emperor Justinian. By this period, however, many exemptions had been allowed, there was pressure for more, and the effectiveness of the tax was weakening.

The Medieval Turnover Taxes

From the Eighth to the Twelfth Centuries, the commerce of Europe was transacted almost exclusively at fairs held under the protection of feudal lords. The sales made at these fairs were taxed. There is evidence that certain types of sales and certain individuals were exempted. These taxes were sometimes paid in coin, but more often in kind.

After the Twelfth Century, turnover taxes developed in the Italian, French, German, Flemish and Spanish commercial cities. The revenue from these taxes was divided between the city treasuries and the feudal overlords of the cities. These turnover taxes were in the form of specific levies on the sales of individual commodities.

The Early French National Turnover Tax

As the French kings acquired power on a national scope during the later Middle Ages, they sought to build up a national revenue. The local turnover taxes existing in the commercial towns suggested the possibility of a turnover tax of national application. In 1292, King Philip the Fair levied a tax of $\frac{5}{8}\%$ on all sales and purchases except small sales and those of foodstuffs.² In 1314 the rate was raised to 2.5%. There was strong opposition to this tax and some of the French commercial towns, by lump sum payments, bought themselves free of it.

After Philip's death the rate of the turnover tax was lowered. Increasing exemptions were allowed. By the middle of the Fourteenth Century the tax had lost its national character and was levied independently and at varying rates in the different provinces. In Paris, in 1386, it reached a height of 7.5%. By the Fifteenth Century many of these provincial turnover taxes had disappeared.

Once again, from 1640 to 1643, a national turnover tax was levied in France. The rate was 5%. Popular opposition was great, and the tax was discarded after three years' trial.

¹ *Ibid.*, pp. 70-106; Seligman, "Studies in Public Finance," pp. 124-125.

² See, Camille Rosier, "Traité théorique et pratique de législation fiscale," Paris, 1926, Vol. I, p. 45; Allix and Lecercle, "La taxe sur le chiffre d'affaires," pp. 1-2.

The Spanish Alcavala

The Spanish kings similarly adapted the municipal turnover taxes of the Spanish cities to their national ends. In 1342 the council (*cortez*) of Burgos granted the revenue from a 5% turnover tax (*alcavala*) to the king of Castile for his military operations. Other cities followed suit. Thereafter, these city turnover taxes were a basic element of the Castilian royal revenues, and with the establishment of the Spanish kingdom they took on the character of a national tax.¹ As the royal treasury declined in the Sixteenth Century, the rate of the tax was increased, until from 1576 to 1584 it was 20%. Thereafter it was held to about 10%. During the Seventeenth Century an innovation was introduced by the levy of an additional tax on retail sales.

In principle, all goods, irrespective of what social class produced them, were to be taxed. In practice, the sales of goods produced on the estates of the King and of the Church were exempted. So, also, were the sales of foodstuffs and of certain hunting accessories.

After a long investigation by a royal commission, the Spanish turnover tax was reformed in 1785. The administration, previously very lax, was strengthened. It was now provided, moreover, that the tax should apply only at the initial transfer of goods. The rate for most articles was fixed at 2%; cattle sales were taxed 4%; the tax on imported luxuries was fixed at 10%.

The weakness of the Spanish power during the succeeding decades resulted in the collapse of this well-intentioned system. In some parts of the kingdom the turnover tax disappeared entirely or was replaced by lump sum payments. Elsewhere, the rates were increased. The Spanish turnover tax was finally abolished in 1819.

The Alcavala in Spanish America

Throughout the Sixteenth Century the Spanish crown urged the introduction of the *alcavala* into the Spanish colonies, but the opposition of the colonists delayed this step until the end of the century.² The tax was established in New Spain in 1574, in Guatemala in 1576, in Peru in 1591, and later in Quito. The rate was 2% (after 1637, 4% in the northern provinces). It was often compounded by the towns.

Planters and ranchers reported their sales to the collectors three times a year. Itinerant merchants and those making incidental sales had to report their sales within twenty-four hours.

The Bremen Turnover Tax

In 1863 the free city of Bremen levied a $\frac{1}{10}$ % tax on sales.³ A specified list of articles was exempted, as well as sales amounting to less than 50

¹ Geronymo de Uztariz, "The Theory and Practice of Commerce and Maritime Affairs," English translation, London, 1751, Vol. I, p. 81; Louis Baudin, "Une ancêtre de la taxe sur le chiffre d'affaires: l'alcavala espagnol," *Revue Politique et Parlementaire*, Vol. 112, pp. 429-439.

² C. H. Haring, "The Early Spanish Colonial Exchequer," *American Historical Review*, Vol. XXIII, pp. 786-787.

³ Grabower, "Geschichte der Umsatzsteuer," pp. 188-194.

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thalers in the course of a day. The merchants of Bremen complained that this tax placed them at a competitive disadvantage with the merchants of other parts of Germany, and the tax was abolished in 1884.

THE MODERN GERMAN TURNOVER TAXES

Germany was the first of the European powers to experiment with, and apply, the principles of general sales or turnover taxation in the Twentieth Century.

The Commodity Transfer Stamp Tax of 1916

In 1916 the Imperial Administration gave thought to the possibility of a general payments tax—a universal tax on transfers of money, checks and all other means of monetary or credit payment.¹ This proposal was early abandoned in favor of a turnover tax based on commodity transfers. The tax law of June 26, 1916 provided for a commodity transfer stamp tax (*Warenumsatzstempelsteuer*) with a rate of 0.1%. This tax was a "stamp tax" in name only. In the case of business concerns, the tax was based on an annual return of sales, with an exemption of M. 3,000 allowed. In the case of individuals, only transfers with a value in excess of M. 100² were taxed. In these cases the tax was collected through a revenue stamp attached to the instrument of sale. Only the transfers of commodities were taxable under this 1916 law; transfers of landed property, separately taxable, did not come under the commodity transfer stamp tax, nor did services.³

The General Turnover Tax of 1918

The further development of the 1916 tax was borne in mind from the very beginning. In Reichstag discussions and in private publications there were proposals for special taxes on the first transfer of commodities, on the sale of raw materials, and on final retail sales to the ultimate consumer. A proposal for a special sales tax on the final purchase of luxury articles came up in the Reichstag in 1917, but failed of passage. After serious consideration, the administration determined upon a general turnover tax (*Umsatzsteuer*) at a 0.5% rate, covering services as well as the transfer of commodities, coupled with special taxes on the retail sale of luxuries, with rates between 10% and 20%.⁴ These proposals were put before the Reichstag in April, 1918, together with proposals for eleven other specific levies—a beer excise, a wine excise, and so forth. The opposition of the social radicals was fruitless. The only important deviation from the original administra-

¹ R. van der Borcht, "Die deutschen Kriegsteuergesetze von 1916," *Finanz Archiv*, 1916, pp. 750-756.

² Johannes Popitz, "Gesetz über einen Warenumsatzstempel vom 26. Juni, 1916," *Jahrbuch des Steuerrechts*, 1920, pp. 325-333.

³ R. van der Borcht, "Die deutschen Kriegsteuergesetze von 1918," *Finanz Archiv*, 1919, pp. 267-285; Auerbach, "Die Luxusumsatzsteuer," *Zeitschrift für die gesamte Staatswissenschaft*, 1921, pp. 128-133; Alzada Comstock, "Taxation in the Modern State," New York, 1929, pp. 124-130.

tion proposal was that a single rate of 10% on the retail sales of luxuries was agreed upon, instead of the graduated rates of the original proposal. The law as passed was to be effective August 1, 1918, and it was provided that the tax should continue in operation for five years.

This German turnover tax of 1918 deserves special consideration, for it is the earliest and most clearly thought-out example of a general turnover tax in modern tax history. The basis of this turnover tax was "business activity," irrespective of whether it resulted in commodities in a finished state, commodities in an unfinished state, or services. The elements of this concept of taxable business activity were (1) a continuing, legal business or industrial activity (thus excluding incidental sales by individuals), (2) conducted for profit (thus excluding the distribution of commodities or the performance of services at cost or less than cost by charitable organizations and the activity of cooperative associations), (3) of an independent character (thus excluding the services of employees working for wages or salaries), and (4) not appertaining to the liberal professions.¹ Consumption by producers or tradesmen of their own stock was made a taxable transfer by law, but a special exemption of M. 2,000 was allowed on such personal consumption.

For special reasons, certain types of transfer were not made subject to the turnover tax. Exports were exempted, in order to reduce the tax handicap on German goods in foreign markets. Mainly because of the special circumstances of Germany's economic situation during the first years of the post-war period, the importation of commodities was exempted from the turnover tax. The first transfer of such commodities after importation was also exempted, unless this was a retail sale, with a view to protecting domestic importers from the indirect discrimination of the turnover tax against them and in favor of foreign exporters. For general economic considerations, transfers of the precious metals were exempted from the tax. The transfer of securities and credit instruments, transfers of land and leases (except of furnished rooms and movables), transportation, lotteries and insurance were excluded from the tax. These excluded transfers and services, however, were already taxed by independent transfer taxes; their exclusion from the general turnover tax was only to avoid double taxation. Finally, a general minimum annual exemption of M. 3,000 was allowed.

The basis of the 10% luxury tax was two-fold. On the one hand a specified list of obviously luxury articles, such as jewelry, furs, antique furniture, and so forth, was subjected to this tax. In addition, commodities that in general would be classified as necessities and semi-necessities, but which were of special quality, were held to be luxuries and subjected to the tax. There was also a two-fold division in the administration of this luxury tax. On a specified list of luxury articles the tax was collected as an excise from the producer (*Herstellersteuer*), and all later sales of such commodities were subject only to the rate of the general turnover tax.

¹ Johannes Popitz, "Kommentar zum Umsatzsteuergesetz vom 26. Juli, 1918," Berlin, 1918, pp. 50 ff.; also, Popitz, "Das (alte) Umsatzsteuergesetz vom 26. Juli, 1918," *Jahrbuch des Steuerrechts*, 1920, pp. 334-348.

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In all cases not covered by this specified list, the tax was collected as a retail sales tax (*Kleinhandelsteuer*).

Modifications of the 1918 Tax

Before the full effects of the 1918 turnover tax could be determined, an upward revision was made by the finance law of December 24, 1919,¹ of which the left wing parties, now controlling the Reichstag and desperately striving to avert national bankruptcy, were the proponents. The rate of the general turnover tax was raised from 0.5% to 1.5%, and that of the luxury tax from 10% to 15%. The exemption of the liberal professions was abandoned with the exception of doctors paid out of governmental funds. The minimum exemptions of the 1918 law were abolished. In their place an anomalous rebate was allowed to those merchants paying the tax who had dependent children under the age of sixteen. This rebate was graduated directly according to the number of the merchant's children, and inversely according to his annual net earnings. The general scheme of this tax was further rounded out by the imposition of a special tax on published advertisements, with rates graduated from 10% to 19%, and by the imposition of a tax on the renting of lodgings and furnished rooms.

Minor modifications of the German turnover tax were made in 1920, the most important being the abolition of the special rebate based on dependent children. By a revision of April 1, 1922, the rate of the general turnover tax was increased to 2%, the increase beginning retroactively January 1, 1922. Later amendments in 1922 and 1923 raised the rate of the tax to 2.5%, beginning with January, 1924, taxed and subsequently untaxed export sales, brought auxiliary import business under the tax, and extended the scope of the luxury and advertisement taxes. Provision was also made, in view of the fluctuating value of the mark, for the calculation of the tax in gold marks.²

Reduction of the General Turnover Tax

By the later months of 1924, Germany's fiscal crisis was passing, and a thought could be given to questions of tax reduction. It was widely felt that a 2.5% general turnover tax placed a heavy burden both on German industry and on German living conditions; in particular, the inclusion of the tax on export values was believed to injure Germany's position in international trade.³ Executive decrees in the closing months of 1924 and the opening months of 1925 reduced the rate of the general turnover tax, first to 2%, operative from October 1, 1924, and then to 1.5%, operative from January 1, 1925. At the same time, the rate of the luxury tax was lowered to 10%.

¹ Johannes Popitz, "Das (neue) Umsatzsteuergesetz vom 24. Dezember, 1919," *Jahrbuch des Steuerrechts*, 1920, pp. 349-369; R. van der Borcht, "Die Reichsteuergesetze vom 1919/20," *Finanz Archiv*, 1920, pp. 436-447.

² Rolf Grabower, "Das Umsatzsteuerrecht," *Jahrbuch des Steuerrechts*, 1924, pp. 209-295.

³ Luther, "Denkschrift," p. 2.

Increasing pressure was now being brought in favor of a further lowering of the rate of the turnover tax, if not for its complete abolition.¹ The organizations of wholesale merchants were particularly active in this movement. It is not surprising, therefore, that the great fiscal reform of the summer of 1925 included a further reduction of the turnover tax.² The rate of the general turnover tax was cut, first to 1.25% and later to 1%; the rate of the luxury tax was reduced to 7.5%. Again, in 1926, the rate of the turnover tax was reduced.³ It was the desire of the administration to bring the rate of the general turnover tax down to 0.5%, but the Reichstag set the rate of the general turnover tax at 0.75%, and the luxury turnover tax was abolished outright. At the same time; the services and productions of scholars, artists and authors were exempted from the tax when the annual turnover total for the individual was under M. 6,000. Farm produce consumed by the agriculturist and his family was exempted. No further change in the rates or general character of the tax has been made since 1926.

Yield of the German Turnover Taxes

During its early years, the yield of the turnover tax proved a severe disappointment to the German treasury authorities.⁴ When the proposal for the 1916 turnover stamp tax was before the Reichstag, it was predicted that the annual yield would be M. 225 millions. During the twenty-two months of its operation, the tax produced only M. 221 millions. The 1918 tax was expected to yield M. 1,200 millions annually for the national treasury, exclusive of the 15% of the total yield earmarked to the states and the local governments. It was soon seen that this expectation would not be realized, and in the 1919 national budget only M. 960 millions were attributed to the turnover tax. The total receipts for the fiscal year ended March 31, 1920 were M. 803.7 millions, of which 15% passed to the states and localities. However, with improving administration of the tax, with increasing rates, and with the progressive economic recovery of German industry and business, the yield of the turnover tax, both absolutely and relative to the total national revenue of Germany, mounted, as shown in Table 7. The year of greatest relative yield was from April, 1924 through March, 1925, when the general turnover tax plus the luxury taxes produced R.M. 1,913.6 millions, 27.5% of the federal internal revenue and 26.2% of the federal government's total tax revenue. The reductions of the rates of the tax after 1924 and the abolition of the luxury turnover tax reduced the annual yield, and since 1926 it has been under R. M. 1,000 millions.

¹ See Rolf Grabower, "Die Durchführung der Umsatzsteuer in vier Nachbarländern Deutschlands," *Steuer und Wirtschaft*, Vol. IV, p. 1772.

² Rolf Grabower, "Das Umsatzsteuerrecht," *Jahrbuch des Steuerrechts*, 1925, pp. 415-458.

³ Max Vehlou, "Die Umsatzsteuer," in Georg Strutz, "Handbuch des Reichsteuerrechts," Berlin, 1927, pp. 576-658.

⁴ Robert Kuczynski, "Ein Reichsfinanzprogramm für 1920," *Recht und Staat in Geschichte und Gegenwart*, Vol. 17, Tübingen, 1920, p. 49.

TABLE 7: RECEIPTS FROM THE GERMAN TURNOVER TAXES, FISCAL YEARS 1921 TO 1929

(Source: *Wirtschaft und Statistik*)

Tax	April, 1920 to March, 1921	April, 1921 to March, 1922	April, 1922 to March, 1923	April, 1923 to March, 1924	April, 1924 to March, 1925	April, 1925 to March, 1926	April, 1926 to March, 1927	April, 1927 to March, 1928	April, 1928 to March, 1929
<i>Amount (in millions)</i>									
Allgemeine Umsatzsteuer.....	..	..	..	..	R.M. 1,794.5	R.M. 1,338.3	R.M. 864.7	R.M. 877.6	R.M. 999.8
Erhöhte Umsatzsteuer.....	..	..	..	..	119.1	77.7	10.8	..	..
Total turnover taxes	M. 4,203.8	M. 11,195.2	M. 228,537	G. M. 608.0	R.M. 1,913.6	R.M. 1,416.0	R.M. 875.5	R.M. 877.6	R.M. 999.8
Total federal internal revenue.....	41,715.0	81,437.9	1,262,924	1,496.1	6,955.3	6,265.7	6,233.3	7,239.4	7,918.2
Total federal tax revenue.....	46,102.1	..	1,545,328	1,626.1	7,311.7	6,856.1	7,173.7	8,490.4	9,022.7
<i>Per Cent</i>									
Proportion of total turnover taxes to:									
Total federal internal revenue.....	10.1	13.7	18.1	40.6	27.5	22.6	14.0	12.1	12.6
Total federal tax revenue.....	9.1	..	14.8	37.4	26.2	20.7	12.2	10.4	11.1

THE FRENCH TURNOVER TAXES

In the spring of 1914 a special limited retail sales tax was enacted in France. With the idea of checking the encroachments of large merchandizing establishments upon small enterprises, the tax law of March 29, 1914 established a special progressive tax upon the sales of retailers with an annual turnover in excess of a million francs. The rate was 1.2% on the first million francs, or fraction of a million francs, over an annual turnover of a million francs, and increased with each million francs to 6% on the excess over fr. 200 millions. These rates were reduced in 1917 when the retail sales tax was levied.

This tax, though always subject to severe criticism, has persisted down to the present. In 1923, the year of its greatest yield, this tax produced fr. 27.5 millions of revenue, collected from 1,819 firms. It is of considerable importance in the history of French turnover taxation, however, since it was often referred to in the debates on the 1917 turnover tax, and undoubtedly influenced the form eventually given to this tax.

The Retail Sales Tax of 1917

The first suggestions for a broad turnover tax appeared in 1915,¹ when the French government was entering upon a course of heavy borrowing. The administration considered the project until 1917 and then laid a proposal before the Chambre for a 1% commodity transfer tax coupled with a 5% retail sales tax and a 10% luxury tax. Before this measure could be acted upon, there was a change in ministries, and the new finance minister, M. Klotz, placed a milder proposal for a retail sales tax before the Chambre. The measure passed almost as proposed. It provided for a 0.2% tax on retail sales exceeding fr. 150, the tax to be collected by stamps sold to purchasers; coupled with this general retail sales tax was a 10% tax on the retail sale of specified luxuries.²

The Commodity Transfer Tax of 1920

By 1919 it was realized that broader sources of tax revenue would have to be tapped. The proposal of a commodity transfer tax was again brought forward. The administration suggested a 1% commodity transfer tax, which it estimated would yield fr. 4.2 billions annually; in arriving at this estimate, the administration assumed five turnovers per commodity, in itself considerable of an overestimate, and then crudely multiplied the yield of the retail sales tax by this estimate of turnover, omitting to take into account the fact that the first turnover of each commodity would not be made at the high price of the retail sale. Later the administration revised its estimate of the possible revenue yield of the proposed commodity transfer tax and asked for a rate of 1.5%. The Chambre was unduly optimistic as to

¹ Toujas, "L'impôt sur le chiffre d'affaires," Toulouse, 1921, p. 6.

² On the 1917 and 1920 turnover tax laws, see: Auerbach, *op. cit.*, pp. 121-127; Georges Bonnet and Roger Auboin, "Les finances de la France," Paris, 1921, pp. 248-260; Toujas, *op. cit.*, pp. 6 ff.; Georges Vincent, "L'impôt sur le chiffre d'affaires," Paris, 1921.

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possible yield, and on June 25, 1920 voted only a 1% commodity transfer tax (*impôt sur le chiffre d'affaires*), which it thought would yield fr. 5 billions annually. An additional 0.1% was added to the levy for distribution to the local governments.¹ The tax was based on the gross monthly sales of manufacturers and merchants; in special cases it was provided that the tax period might be longer than a month—quarterly, semi-annually or annually. The administration was authorized to set minimum fees for petty shop keepers with turnovers under fr. 1,000 or fr. 4,000 according to their character.

The law of 1920 made all those who habitually or occasionally sold articles of commerce or articles manufactured by themselves, even though no profit should arise, subject to the tax. Railroads and public utilities were outside the scope of the tax because their rates were regulated. Farmers were not subject to the tax on the sale of their crops, this act being held not to be an "industrial or commercial" act within the meaning of the law. The creations of independent artisans and the services of licensed members of the liberal professions were not taxed. As a concession to popular feeling, the sale of bread was exempted from the tax; the sale of newspapers was also exempted as a special privilege. Transfers and sales otherwise taxed, such as stock transfers and the sale of pharmaceutical goods, theatre tickets and liquors, were exempted from the commodity transfer tax.

The 10% tax on sales of luxuries under the 1917 tax law was retained with an enlarged scope. The definition of luxuries was two-fold; certain specified articles were indicated in the law as luxuries *per se*, while in other cases, the *price* determined whether the article belonged in the necessity or luxury class. The 1920 law, in addition, levied a tax on the charges of hotels, restaurants, boarding houses and other establishments providing guest service. These were divided into three categories; establishments *de luxe* were taxed 10% on their services, semi-luxury establishments were taxed 3%, and all others were taxed at the 1.1% rate of the commodity transfer tax.

Modifications of the Commodity Transfer Tax

No significant changes were made in the French commodity transfer tax until 1923. In that year it was provided, for administrative reasons, that the luxury tax on the sale of automobiles should not be paid on the occasion of the retail sale, but should be collected from the manufacturer as an excise. The sale of war mementoes was exempted from the tax during the same year. The creations of independent artisans were now brought under the tax.

¹ On the 1920 French turnover tax and its modifications, see Franz Scholz, "Grundriss des französischen Steuerrechts unter besonderer Darstellung des französischen Umsatzsteuerrechts," *Veröffentlichungen der Steuerstelle des Reichsverbandes der Deutschen Industrie*, Vol. 4, Berlin, 1925, pp. 105-184; Rosier, "Traité théorique et pratique," Vol. II, pp. 9-60; Joachim Lemcke, "Die Vorgeschichte und gegenwärtige Gestaltung des französischen Steuersystems," *Finanzwirtschaftliche und Volkswirtschaftliche Studien*, Vol. 8, Jena, 1928, pp. 149-157; Allix et Lecercle, *op. cit.*; Comstock, *op. cit.*, pp. 130-136.

In 1924, the rate of the commodity transfer tax was increased from 1.1% to 1.3%, and the rates of the guest-service taxes were raised from 3% to 3.6% and from 10% to 12%. It was also provided that shopkeepers with small turnovers might have their annual turnover tax liability arbitrarily based on a calculation of the preceding year's turnover, and pay the tax in quarterly instead of monthly installments, thus relieving them from the necessity of detailed bookkeeping and reporting. In 1925, meats and coal and coke were subjected to special taxes, and their sale was therefore exempted from the commodity transfer tax. Modifications were also made in the system of import turnover taxes. Proposals for the retail exemption of all foodstuffs and for the exemption of all establishments with less than three employees failed.

In 1926, the rate of the general commodity transfer tax was again raised, this time to 2% for sales other than retail and to 2.5% for services, the increased rate to be effective for the remainder of the year; the rate on retail sales and newspapers was retained at 1.3%. The tax on the services of first class hotels was raised to 13%, that on second class establishments to 4%, while third class establishments were taxed at the 2% rate of the commodity transfer tax. In 1926, moreover, the law of the commodity transfer and luxury taxes was codified, giving these taxes a more permanent aspect than heretofore; the increased schedule of rates was made permanent, and retail sales and services were taxed at the 2% rate. Changes in the turnover tax law in 1927 and 1928 dealt with the taxation of imports and exports.

Yield of the French Turnover Taxes

The yield of the French turnover tax has increased steadily since its levy, as shown in Table 8. In 1920, the retail sales tax and luxury tax combined produced fr. 942.2 millions. The change to a commodity transfer tax more than doubled the yield of the French turnover tax, and the revenue from this source in 1921 was fr. 1,910.6 millions, 17.7% of the internal revenue and 15% of the total tax revenue for that year. Rate increases and improving administration have steadily increased the yield of the French turnover tax and, as Table 8 indicates, its relative importance in the French national tax system has grown. The fr. 7,488.5 millions collected from the French turnover taxes in 1926 represented 23.2% of the internal tax revenue and 21.2% of the total national tax revenue. After 1926, the turnover tax was the largest single source of French tax revenue, displacing the income tax in this respect.

THE BELGIAN TURNOVER TAXES

The first Belgian turnover tax law was passed in 1921. The Belgian administration, therefore, could utilize the experience of the German and French turnover taxes. The experience was not without its effect on the form of the Belgian tax, for instead of being of a business tax based on the gross incomes of manufacturers and merchants, the Belgian turnover tax was levied as a transfer stamp tax, the stamps to be attached to all invoices

TABLE 8: RECEIPTS FROM THE FRENCH TURNOVER TAXES, 1921 TO 1928

(Source: Bulletin de Statistique et de Legislation Comparée. Computed by National Industrial Conference Board)

Tax	1921	1922	1923	1924	1925	1926	1927	1928
<i>Amount (in thousands)</i>								
Turnover tax.....	fr. 1,897,457	fr. 2,280,266	fr. 3,015,801	fr. 4,090,482	fr. 4,535,118	fr. 6,852,248	fr. 7,909,597	fr. 8,351,053
Consolidated tax on coal...	..	..	..	..	..	198,213	212,934	192,832
Consolidated tax on meat...	..	..	..	..	..	311,908	390,622	403,182
Consolidated tax on tea and coffee.....	..	..	..	..	..	..	..	196,719
Consolidated tax on animal foods and fertilisers.....	..	..	..	..	..	..	..	85,530
Consolidated tax on sugar...	..	..	..	..	..	..	..	31,337
Export turnover tax.....	..	..	..	..	..	105,549	92,329	1,543
Luxury tax.....	13,114	20,438	14,953	19,485	19,930	20,612	24,173	23,077
Total turnover taxes...	fr. 1,910,571	fr. 2,300,704	fr. 3,030,754	fr. 4,109,967	fr. 4,555,048	fr. 7,488,530	fr. 8,629,655	fr. 9,285,273
Total national internal revenue.....	(1)	12,875,385	15,604,062	20,831,523	23,218,504	32,284,098	(1)	(1)
Total national tax revenue.....	(1)	15,298,492	18,001,284	23,257,728	25,431,252	35,303,859	(1)	(1)
<i>Per Cent</i>								
Proportion of total turnover taxes to:								
Total national internal revenue.....	..	17.7	19.4	19.7	19.6	23.2	..	..
Total national tax revenue.....	..	15.0	16.8	17.4	17.9	21.2	..	..

¹ Figures not available.

and bills of sale. By this method it was hoped to overcome the administrative weaknesses that the German, and particularly the French, turnover taxes had shown.

The Commodity Transfer Stamp Tax of 1921

The tax law of August 28, 1921 provided a stamp tax (*taxe de transmission*) on the sale or exchange of commodities, with a rate of 1% of the sale or exchange price.¹ The sale of bread, flour for bread baking, meat and such other articles of first necessity as might be indicated by royal decree, and the transmission of water, gas and electricity were exempted from the tax. So, also, were sales under fr. 30 in amount; all sales made to the same person in the course of a day were considered a single sale so far as this exemption was concerned. An exemption of fr. 150 was also allowed to the farmer on the sale of his produce directly to a consumer.

Coupled with this commodity transfer stamp tax was a 5% tax on meals and lodgings above a fixed price, and on the sale of specified luxury articles. A series of taxes on commissions, on transportation and transmission, on stock transfers and on display advertising built up the commodity transfer tax to somewhat of a general turnover tax.

Modifications of the Commodity Transfer Stamp Tax

Experience soon showed that the Belgian commodity transfer stamp tax, instead of being shifted in its entirety to consumers as was intended, rested upon producers and merchants who were in competition with combinations or associations which produced or marketed similar goods by methods involving fewer taxable transfers. To end this discrimination, and also for social reasons, the law of January 2, 1926 provided that a consolidated tax of 2% should be paid at one particular stage of the productive or distributive process of vegetable products, butter, by-product animal foods and fertilizers, and flax. A 1% consolidated tax was set for the sale of bread grains, coal and coke products and exported flax. The law provided that the series of transfer taxes on other commodities might also be consolidated at 2% by royal decree. The inspiration for this "consolidation" clearly came from the Austrian turnover tax law of 1922.²

The same law classified meals and lodgings according to the prices paid, and levied luxury taxes of 6%, 8% and 12% on them. General luxuries were also divided into two groups and their retail sale taxed 6% and 12%.

A law of June 8, 1926 raised the general rate of the tax to 2%. The lump-sum rates were also doubled to 4% and 2%. In addition, the sales of coal, gas and electricity, previously exempted, were taxed at a 2% lump-sum rate. The earlier exportation exemption of certain articles was ended. The luxury tax on meals and lodgings and on the heavier-taxed luxuries was set at 10%, but the schedule of prices determining the luxury character of such items was raised in view of the general rise in price levels. Still

¹ Robert J. Lemoine, "Budgets und Steuern in Belgien nach dem Kriege," *Finanz Archiv*, 1928, p. 166; articles by Rolf Grabower in *Steuer und Wirtschaft*, 1925, 1926 and 1928; Comstock, *op. cit.*, pp. 137-140.

² See p. 179 of this volume.

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later in the year the general luxury tax was split into two taxes. The first, at the rates of 6% and 10%, according to the character and price of the articles specified, was levied on the occasion of production or of importation. The second, at the same rates, was levied on the occasion of the retail sale of the specified commodities.

The modifications of 1927 and 1928 were of double character. On the one hand, the schedule of prices determining the "luxury" character of lodgings was raised and the rate of the tax was reduced to 5%, the tax on cakeshop and tea room service being maintained at 10%. On the other hand, a series of royal decrees provided for the consolidation of the tax on a number of specific commodities, mostly foodstuffs, at ratios of 4%, 3% and 2%. Hand in hand with this development of consolidation taxes went a provision for the rebate of these taxes upon the export of the taxed commodities.

Yield of the Belgian Turnover Taxes

The rate increases of the Belgian turnover and luxury turnover taxes have given these taxes first place in the Belgian tax system as revenue producers. Prior to the rate increase of 1926, these two taxes produced fr. 480 millions annually, 13.6% of the national internal revenue and 11.8% of the total national revenue, as shown in Table 9. Three years later, in 1928, the yield of the turnover and luxury turnover taxes had quadrupled, whereas the national tax revenue, as a whole, had only doubled. The fr. 2,160 millions of turnover tax revenue in 1928 was 27.2% of the Belgian internal tax revenue and 23.9% of the total national revenue.

THE ITALIAN TURNOVER TAX

During the war and post-war periods, the Italian government levied stamp taxes on the retail sale of a series of specified luxuries. These were superseded by the commodity transfer tax of March 18, 1923. A later modification joined to this commodity transfer tax those of the earlier independent sales taxes—on wines and perfumes—which had not been abolished. The combined tax was known as *la tassa generale di bollo sugli scambi commerciali*—the general stamp tax on commercial operations.

The Commodity Transfer Tax of 1923

The tax levied by the 1923 law rested upon commercial transfers between producers and merchants.¹ Not only those who customarily made commercial sales, but also those who occasionally, as an incident to their general business, made sales to producers or merchants, were subjected to the tax. The final retail sale, however, between merchant and consumer was not brought under the tax, since under the Italian law it was not a "commercial" transaction; a semi-exception to this principle was made in the case of expensive luxury articles which were taxed when sold by pro-

¹ Alberto De Stefani, "Lezioni sugli ordinamenti finanziari italiani," Rome, 1926, pp. 209-221.

TABLE 9: RECEIPTS FROM THE BELGIAN TURNOVER TAXES, 1921 TO 1928

(Source: Belgian Ministry of Finance)

Tax	1921	1922	1923	1924	1925	1926	1927	1928
<i>Amount (in millions)</i>								
Taxe de transmission	fr. 41.6	fr. 280.3	fr. 345.9	fr. 450.0	fr. 450.0	fr. 700.0	fr. 1,250.0	fr. 1,500.0
Taxe de luxe .....	..	9.0	19.0	30.0	30.0	150.0	475.0	560.0
Total turnover taxes	fr. 41.6	fr. 289.3	fr. 364.9	fr. 480.0¹	fr. 480.0¹	fr. 850.0¹	fr. 1,725.0¹	fr. 2,160.0¹
Total national internal revenue....	995.7	1,623.4	2,762.1	2,961.0	3,516.9	5,228.5	7,013.2	7,936.7¹
Total national tax revenue	1,246.8	2,019.3	3,125.6	3,394.2	4,068.1	5,937.1	7,914.6	9,033.8¹
<i>Per Cent</i>								
Proportion of total turnover taxes to:								
Total national internal revenue....	4.2	17.8	13.2	16.2	13.6	16.3	24.6	27.2
Total national tax revenue.....	3.3	14.3	11.7	14.1	11.8	14.3	21.8	23.9

¹ Estimate by Belgian Ministry of Finance.

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ducers to consumers, so as to discourage attempts at avoidance of the tax by direct purchase from producers.

Four rates of taxation were provided. Transfers of raw materials exclusive of luxury articles and precious stones, construction materials, ingot metal, and agricultural implements were taxed 0.5%. Transfers of all commodities not included in the 0.5% rate above or in the 2% and 3% rates mentioned below were taxed 1%. Transfers of a specified list of luxury articles, including precious stones, silks, ivory and amber objects, laces, oriental rugs and automobiles above 25 horsepower were taxed 2%. Transfers of pharmaceutical specialties, perfumes, mineral waters and effervescent wines were taxed 3%. Food products of first necessity, whether domestic or foreign, combustibles, washing soap, water, gas and electricity, and the objects of the state monopolies were not subject to the tax. In general, sales of domestic farm products were not taxable, since agriculturalists were not held to be industrial producers or merchants under the Italian law. Imports were taxed at entry; exports were exempt.

Unlike the turnover taxes of most of the other European countries, the Italian tax was not collected on the basis of periodical returns, but through a stamp or remittance attached to a duplicate bill of sale for each transaction. If the tax on the transaction exceeded lire 1,000, it might be paid by a money order; if the tax was for a smaller amount, it might be paid by revenue stamps affixed to the bill of sale or by a remittance in any suitable medium accompanying the document. Administration of the law was strict, and infractions were punished by fines amounting to ten times, twenty times and one hundred times the tax.

The original law provided that the tax on certain articles, such as meat and wine, should be lump-summed; in the case of meat, the tax was paid at the time the animal was slaughtered, and all subsequent transfers of its flesh were not taxable.

Yield of the Italian Turnover Tax

Without changes in the rate schedule or the essential structure of the Italian turnover tax, its yield increased from lire 271.7 millions for the fiscal year ended in June, 1923, to lire 889.5 millions for the fiscal year ended in June, 1926, as shown in Table 10. In the latter year, the revenue from the Italian turnover tax represented 7.6% of the national internal revenue and 6.1% of the total national tax revenue. Improvement in the administration of the tax through continued experience, currency depreciation and growth in the turnover of Italian business account for the increase in yield.

In the fiscal years ended in 1927 and in 1928, as the value of the lira increased, the yield of the Italian turnover tax fell off, as did the yield of the Italian taxes generally, and in the latter year the revenue from the Italian turnover tax was lire 642.7 millions.

THE AUSTRIAN TURNOVER TAX

A general turnover tax was first proposed in Austria in 1920. Failing of acceptance in this year, it was again brought up in 1922 and was included

TABLE 10: RECEIPTS FROM THE ITALIAN TURNOVER TAX,
FISCAL YEARS 1923 TO 1928
(Source: Conti Riassuntivi del Tesoro)

Tax	July, 1922 to June, 1923	July, 1923 to June, 1924	July, 1924 to June, 1925	July, 1925 to June, 1926	July, 1926 to June, 1927	July, 1927 to June, 1928
<i>Amount (in millions)</i>						
Tassa sugli scambi commerciali.....	lire 271.7	lire 581.8	lire 758.5	lire 889.5	lire 783.2	lire 642.7
Total national internal revenue.....	lire 8,692.9	lire 10,998.8	lire 10,710.6	lire 11,709.6	lire 11,550.2	lire 10,674.2
Total national tax revenue.....	10,811.6	13,182.1	13,024.5	14,564.8	14,297.5	13,301.3
<i>Per Cent</i>						
Proportion of total turnover taxes to:						
Total national internal revenue.....	3.1	5.3	7.1	7.6	6.8	6.0
Total national tax revenue.....	2.5	4.4	5.8	6.1	5.5	4.8

in the Finance Law of November 27, 1922¹, linking up with earlier bank and security transfer taxes. The rate for 1923 was fixed at 1% on general inland sales and commercial services, while the sale of luxuries was taxed 12%. This 1922 law provided that the general turnover tax rate for 1924 should be 2%.

Rate Consolidation

The unusual feature of the Austrian turnover tax law was the provision, first made by decree of March 11, 1923, for the consolidated payment of the tax covering all turnovers of given commodities, thereby eliminating the usual discrimination of the tax in favor of multiple-process concerns and against independent-process enterprises.² The problems of determining the commodities to which this consolidated payment would apply, and of determining the rate of the consolidated payment, were left to the administration. According to the consolidated rates set on the basis of the 1923 rate of 1%, the lump-sum taxes varied from 2% to 6%, with 3.5% as an average rate. The payment of this consolidated tax at one or another of a commodity's industrial or commercial stages exempted all subsequent and prior transfers from the turnover tax. The consolidated tax on flour, for example, which was 4%, covered the sale of bread and all baked products; the 4% consolidated tax on meat covered the manufacture and sale of bolognas; the 3% consolidated tax on milk covered the manufacture

¹ Victor Kienbock, "Das österreichische Sanierungswerk," Finanz und Volkswirtschaftliche Zeitfragen, Vol. 85, Berlin, 1925, p. 169; Rolf Grabower, "Die wirtschaftlichen Hauptfragen der allgemeinen Umsatzsteuer und ihre Regelung im Inland und im Ausland," Steuer und Wirtschaft, Vol. IV, pp. 36-43; Rudolf Müller, "Die indirekten Bundesabgaben in Österreich," Vienna, 1928, pp. 369-406.

² See pp. 24 ff. of this volume.

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and sale of butter and cheese. Imports paid an adjusted consolidated turnover tax as well as their regular customs duties. Rebates, calculated on the difference in turnover tax burdens between domestic and foreign products, were allowed on exported goods with a view to offsetting the discrimination against domestic production which it was believed resulted from the domestic turnover tax.

No changes have been made in the fundamental character of the Austrian turnover tax. There have been many modifications of the schedule of consolidated rates and of the corresponding schedule of consolidated transfer taxes to be paid on the occasion of importation, as a result of price changes and changes in consumption demand. The schedule for internal consolidated rates embraces four hundred categories of commodities. The schedules for the import turnover tax and for the export rebate also run to hundreds of categories. One general tendency of recent years to be noted in the Austrian turnover tax is the increasing liberality of the export rebate.

Yield of the Austrian Turnover Tax

Austria places more dependence on the turnover tax as a major element of its national tax system than any other European country. As shown in Table 11, in 1924, the first year of the full operation of the turnover tax, it produced Sch. 202.7 millions, 29% of the national internal revenue and 23.9% of the total national tax revenue. By 1927 the yield of the tax had increased to Sch. 237.1 millions, 30.8% of the national internal revenue and 22.5% of the total national tax revenue.

TABLE 11: RECEIPTS FROM THE AUSTRIAN TURNOVER TAX, 1923 TO 1928

(Source: Austrian Ministry of Finance)

Tax	1923	1924	1925	1926	1927
<i>Amount (in millions)</i>					
Turnover tax.....	Sch. 56.0	Sch. 202.7	Sch. 225.9	Sch. 227.3	Sch. 237.1
Total national internal revenue.....	Sch. 511.1	Sch. 699.3	Sch. 707.0	Sch. 746.2	Sch. 769.0
Total national tax revenue.....	620.9	847.1	907.9	959.9	1009.6
<i>Per Cent</i>					
Proportion of total turnover taxes to:					
Total national internal revenue.....	11.0	29.0	31.9	30.5	30.8
Total national tax revenue.....	9.0	23.9	24.9	23.7	22.5

OTHER EUROPEAN TURNOVER TAXES

Several other European countries have levied general sales or turnover taxes which are contributing materially to their tax revenues. Brief sketches of the more significant of these taxes follow.

The Hungarian Turnover Tax

A 1.5% general turnover tax was levied in Hungary in 1921.¹ The German law was taken as a model, and the tax covered commodity transfers and the performance of commercial and professional services. As distinguished from the German tax, however, imports were taxed at the general turnover tax rate. Combined with this general turnover tax was a luxury tax, with a rate of 10% when collected from retail dealers and 13% when collected from producers.

Subsequent modifications effected important changes in the Hungarian turnover tax. The tax was increased to 3% in 1922, at which rate it produced one-third of the total gross revenue of the state,² and was again lowered to 2% in 1925. The list of exemptions was extended in later years, particularly in 1927. The most significant development was the application of the Austrian principle of consolidating the tax, with consequential consolidated import turnover duties and consolidated export rebates. The Hungarian tax administration also found it advisable to copy the French system of compounding for arbitrary sums the turnover taxes of small dealers and business men, thus relieving them of the necessity of keeping full business books and also relieving the administration of the necessity of checking their returns. A unique administrative feature of the Hungarian turnover tax is the levy of the tax on professional services, not on the professional man himself, but on the associations of professional men. These organizations, whose membership covers all practicing professionals in Hungary, pay the tax for the entire profession, and then assess the tax on their members according to their own standards.

The Czechoslovak Turnover Tax

General and luxury turnover taxes were enacted in Czechoslovakia in 1919 and 1921. In 1923, a revision of the tax law modeled the Czechoslovak tax closely upon the Austrian tax of the preceding year.³ The gross sales price, including costs of packing, transportation, interest charges, and corresponding items, was made the basis of the tax. Sales to or by any agent, as well as transfers between principal and agent, were taxed. An

¹ Wilhelm Lenart, "Das ungarische Steuersystem," *Ungarisches Wirtschaftsjahrbuch*, 1927, p. 249; Comstock, *op. cit.*, pp. 148-149.

² League of Nations, "Financial Reconstruction of Hungary," Report No. XIV, p. 2.

³ Rolf Grabower, "Die Durchführung der Umsatzsteuer in vier Nachbarländern Deutschlands," *Steuer und Wirtschaft*, Vol. IV, pp. 1231-1266; Rudolf Schranil, "Die Steuern und die Steuerbelastung in der tschechoslowakischen Republik im Jahre 1926," *Mitteilungen der Steuerstelle des Reichsverbandes der deutschen Industrie*, 1926, p. 162; Comstock, *op. cit.*, pp. 141-144.

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exceptional feature of the law was the extension of the tax to transfers of objects between establishments under a single ownership, where no real "sale" had occurred. The earlier taxes, as well as that of 1923, provided for consolidating the pyramided tax on certain articles, but the extent of the consolidation under the Czechoslovak law was not as great as under the Austrian tax, and the principle of consolidation has come to be connected with the Austrian rather than with the Czechoslovak tax.

The general rate for the turnover tax was fixed at 1% in 1919 and at 2% in 1921, but the Minister of Finance was given power to raise the rate on sales of foreign goods that competed with domestic products. Sales of agricultural products, bread, meat, game and fish were taxed 1%. Imports were not taxed at entry, but deliveries from abroad contracted for within the country were treated not as imports but as domestic sales, and were subjected to the tax. The rates of the luxury tax were fixed at 12% when levied on the producers or at importation, and 10% when levied on the retail sale.

Changes to the present time have been minor, the most important being a reduction of the list of articles subject to the luxury tax. The turnover tax produces from one-fifth to one-fourth of the Czechoslovak national tax revenue.

The Polish Turnover Tax

A Polish turnover tax, coupled with a business license tax, was first levied in 1923.¹ It was of the commodity transfer type, with the tax in general levied on the reported gross income of merchants and manufacturers. There were several exceptions to this rule, however, for the law authorized deductions on account of discounts, and shipping and insurance expenses defrayed for the buyer; losses by banks in their operations in foreign currencies and in securities were deductible; oil and gas well royalties were deductible from gross receipts.

The basic rate of the tax was 2%, but amendments in 1925 provided for complicated discriminations. Agricultural products were exempted. Dealings in articles of "first necessity" and in raw materials necessary for the development of domestic agriculture and industry were taxed 0.5%. The retail trade in foodstuffs and sales to industrial concerns for further manufacture or for use in their own industries were taxed 1%. A rate of 5% was levied on commissions and other remuneration of commission merchants or commercial middlemen, whether acting as forwarding agents, carriers, or in any other capacity. The tax law gave the Minister of Finance, in conjunction with the Minister of Commerce, the power to lower the tax rate by as much as 1% in the case of specific wholesale dealers and in the case of exports; this power was exercised in decrees of

¹ Republic of Poland, "Reports submitted by the commission of American financial experts headed by Dr. E. W. Kemmerer," Warsaw, 1926, pp. 150-169; Edward Taylor, "Finanzpolitik und Steuersystem der Republik Polen," *Finanzwirtschaftliche und Volkswirtschaftliche Studien*, Vol. 12, Jena, 1928, pp. 239-251; Comstock, *op. cit.*, pp. 144-147; Rolf Grabower, "Die Umsatzsteuer im Ausland während der letzten 12 Monate," *Steuer und Wirtschaft*, Vol. V, pp. 1235-1238.

1925 and 1926. Additional local rates may be, and in some cases are, levied up to one-quarter of the national rate.

Assessment of the tax is made by local boards on the basis of returns submitted, or on presumptive evidence where incomplete or no returns are submitted; the responsibility resting on these local boards is indicated by the fact that in 1925 the tax based on enterprises making no official returns was more than double that on enterprises making returns. The general consensus of opinion of foreign experts who have studied the Polish turnover tax is that it requires much simplification.¹

The Roumanian Turnover Tax

The Roumanian turnover tax, first levied in 1921, combines a commodity transfer tax with a series of luxury taxes. Domestic sales and transfers of manufactured articles and of raw materials, with certain exceptions, are taxed 2%. Exports in certain categories are taxed 1%. The tax is not based on the actual sales price of the article sold or transferred, however, but on an average price per unit as fixed by the Ministry of Finance; the schedule of average prices published for 1927 and 1928 contains 1,893 categories of articles, many of which have numerous subdivisions.

Three categories are set for the luxury tax. The first, including spirits and toilette articles, is subject to a 20% tax. Other luxury articles are subjected to a 15% or a 10% tax, according to their character.

The Turkish Turnover Taxes

In the winter of 1925 the Turkish government levied a tax on commodity sales and certain services with rates at 2% and 2.5%. The exemptions included bread, articles subject to the state monopolies, entertainments, and purchases for hotels and restaurants.

In 1927, Turkey changed the character of its turnover tax from a commodity transfer tax to a production tax on goods manufactured by machine processes. The rate was fixed at 6% for goods intended for internal consumption and 2.5% for goods intended for export. Handicraft industries were exempted, as were bakeries, and the printing of newspapers and books. Imported manufactured articles were taxed 6% at the time of import, in order that the internal tax should not cripple domestic industry. The Turkish government estimated that this general excise would produce 49.7% of its internal tax revenue and 32.3% of its total tax revenue (including customs).

The Turnover Tax of Soviet Russia

Since 1921, the soviet government of Russia has levied a combined license and turnover tax on manufacturers and merchants.² The turnover

¹ Republic of Poland, *op. cit.*, pp. 150-169; E. Hilton Young, "Report on Financial Conditions in Poland," Warsaw, 1924, pp. 57, 58; *Bulletin of the Bank of Poland*, No. 4 (1928), pp. 11, 12.

² Paul Haensel, "Die Finanz- und Steuerfassung der Union der Sozialistischen Sowjet-Republiken," *Finanzwirtschaftliche and Volkswirtschaftliche Studien*, Vol. 10, Jena, 1928, pp. 33-35.

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tax so levied is not pure in form, but is rather a combination of a gross sales tax and a semi-business-income tax. Wholesale and retail merchants are taxed on their gross income; manufacturers are taxed on their gross income minus the cost of their raw materials; transportation companies and financial organizations are taxed on their net income; cooperative associations are taxed on their net income from sales to non-cooperatives.

No general tax rate is fixed, but a schedule with 158 classifications establishes independent rates for various classes of business enterprises. On the average, manufacturers are taxed 1.25%, wholesalers 1% and retailers 1.5%; additional local turnover taxes may double these rates. The rates on cooperative associations are reduced by one-half on dealings with their own members and by one-fourth on dealings with outsiders. In general, the tendency is to tax private enterprises at a higher rate than state or cooperative enterprises. Wholesale dealings in a specified list of luxury articles are taxed 4%, and retail dealings in those articles 6%. Prior to 1927, the administration had the power to raise or lower the turnover tax rate for concerns in exceptional circumstances. This power was abolished in December, 1926, and the tax is now based on a fixed schedule.

The administrative provisions of the Russian tax are detailed and severe, but the meager acquaintance of Russian business men, particularly small retailers, with western accounting methods, makes some leeway in the collection of the tax inevitable. In Moscow, where 22% of the taxable turnovers of Russia occur, 45% of the accounts submitted by merchants in 1926, and 23% of those submitted by manufacturers, proved inadequate for the purposes of the tax.¹ In practice, it is necessary in many cases to make arbitrary estimates of the taxable turnover; in the case of manufacturers, average production per worker or per machine may be used; in the case of merchants, such factors as rent, number of employees, number of customers and so forth are taken into consideration.

THE LATIN AMERICAN TURNOVER TAXES

The *alcavala*, introduced by order of the Spanish crown into Spanish America,² lasted only as long as the New World remained subject to the Old. It was swept away in the struggles for independence during the third decade of the Nineteenth Century and did not reappear for a century. Within the past few years, four Latin American countries—Bolivia, Brazil, Cuba and Ecuador—have enacted turnover tax laws. Several other Latin American countries have extended systems of special excises or consumption taxes. Although in instances the scope of these consumption tax systems is quite broad, they do not have the universality and uniformity necessary to classify them as general sales or turnover taxes.

The Bolivian Turnover Tax

After two years' experience with a 5% business income tax, the Bolivian government was persuaded that its capacities for fiscal administration were

¹ *Ibid.*, p. 43.

² See p. 165 of this volume.

not sufficient to cope successfully with a net income tax. On December 12, 1923, a 0.5% commodity transfer tax and a 2% tax on commercial services were substituted for the business income tax.¹ The new tax extended to all industrial and mercantile sales except such as were already subject to sales taxation under other parts of the national tax system. A minimum exemption was allowed, based, however, not on turnover but on capital investment. The 2% tax on commercial services extended to brokers, express companies, insurance companies, money changers and similar business activities.

The Brazilian Turnover Tax

For three-quarters of a century Brazil has had a "consumption tax," embracing a series of excises on specific commodities or articles. The items subject to the tax are specified and the rates are individual. This tax, like the Mexican consumption tax, did not at first possess the uniformity and universality necessary to a general sales or turnover tax. A law of December 31, 1922, however, rounded out this consumption tax with a general tax on other, heretofore untaxed sales. The rate on retail sales is 2%, on wholesale sales 1%. The sales of their own products by agriculturalists and professional services are exempted. Commercial services are taxed.

The Cuban Commodity Transfer Tax

The Republic of Cuba enacted a 1% commodity transfer tax in October, 1922. It applied to all sales by merchants and manufacturers, and extended to the special services of contractors, wharfingers, drydocks, public services, hotels and restaurants. The exemptions allowed fell into three main categories: (1) the sale of articles already covered by special excises, (2) the sale of agricultural and food products, and (3) a series of minimum exemptions—the sales of merchants with quarterly turnovers under \$1,000, the sales of peddlers with daily turnovers under \$10, and the sales of artisans working at home with individual daily outputs under \$5. The export of raw and partly manufactured products was also exempted. The tax was made payable quarterly.

In 1925 the rate of the tax was increased to 1.5%.

The Turnover Tax of Ecuador

In 1924 a 1% commodity transfer tax was levied in Ecuador. Sales of their own produce by agriculturalists were exempted. The exemption of peddlers' sales, a common element of Latin American turnover taxes, was featured.

THE CANADIAN TURNOVER TAXES

Canada entered the post-war period with high federal income and excess profits taxes. The excess profits tax was soon abolished and sharp reductions were made in the rates of the income tax. Consequently, the Cana-

¹ Charles A. McQueen, "Bolivian Public Finance," Department of Commerce, Trade Promotion Series No. 6, 1925, p. 24.

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dian dominion government had to develop a substitute source of revenue. A turnover tax was enacted in 1920.

The Manufacturers' and Merchants' Sales Tax of 1920

The Canadian dominion revenue law of 1920 (10-11 Geo. V, ch. 71) levied a 1% tax on the sales of manufacturers (when not made directly to retailers or to consumers), of wholesalers and of jobbers, and a 2% tax on the sales made by manufacturers directly to retailers and consumers. A long list of exemptions sharply restricted the scope of the tax. Among the most important exempted articles were uncanned foodstuffs, clothing, fuels, gas and electricity, unbound printed materials, unfinished wood products, metallic ores and crude metals.

In 1921 (11-12 Geo. V, ch. 50) the rates of the Canadian turnover tax were raised and its scope broadened. The rates of the tax were increased one-half, and a new category introduced by taxing sales of lumber by Canadian producers at 2%. The list of exemptions was expanded and the Governor in Council was empowered to add to the list of exemptions specified in the law. Compensating import duties of 2% on wholesale merchants' imports and 4% on importations by retailers and consumers were levied by the same law; the importation of lumber was taxed 3%. Export sales were not taxed; moreover, a drawback or rebate up to 99% of the sales tax previously paid was allowed on exported articles.

In the following year (12-13 Geo. V, ch. 47) the rates of the manufacturers' and merchants' sales tax were again increased by one-half. The exemption accorded to foodstuffs was increased by specific mention of salt, evaporated and powdered milk and various flours.

The Manufacturers' Excise of 1923

In 1923 (13-14 Geo. V, ch. 70) the character of the Canadian turnover tax was changed from a manufacturers' and merchants' sales tax to a production tax on manufacturers. The rate was fixed at 6%, and lumber was taken off the list of specially treated articles.

In order to assure the payment of the tax once, but not more than once, on all manufactured articles, and also to simplify the administration of the tax, it was provided that all manufacturers who produced more than \$10,000 of goods annually should be licensed. Also, wholesale merchants and jobbers selling more than 50% of their turnover to licensed manufacturers were required to be licensed. Such part of a manufacturer's output as was sold to other licensed manufacturers or wholesalers was exempted from the tax, the entire tax on the finished article being paid by the manufacturer of the finished article, whether he purchased directly from the manufacturer of the unfinished article or through the medium of a licensed wholesaler. The sales made by licensed wholesalers to retailers, consumers or unlicensed manufacturers were taxed. Apart from the exempted list, the only goods manufactured in Canada escaping the tax were those produced from raw material or exempted commodities by unlicensed manufacturers (those producing less than \$10,000 of goods a year) and sold directly to retailers and consumers, or to unlicensed wholesalers and by

TABLE 12: RECEIPTS FROM THE CANADIAN TURNOVER TAXES, FISCAL YEARS 1921 TO 1928
(Source: Canadian Year Books)

Tax	April, 1920 to March, 1921	April, 1921 to March, 1922	April, 1922 to March, 1923	April, 1923 to March, 1924	April, 1924 to March, 1925	April, 1925 to March, 1926	April, 1926 to March, 1927	April, 1927 to March, 1928
<i>Amount (in thousands)</i>								
Domestic sales	\$27,910	\$44,820	\$62,686	\$71,835	\$51,253	\$57,254	\$63,940	\$55,379
Import sales	10,218	16,699	28,577	29,155	15,454	16,771	18,366	16,721
Total dominion turnover tax¹	\$38,128	\$61,519	\$91,263	\$100,990	\$66,707	\$74,025	\$82,306	\$72,100
Total dominion internal revenue²	205,503	214,239	217,397	220,218	185,768	200,220	204,680	207,684
Total dominion tax revenue²	368,770	319,926	335,453	341,719	293,915	327,575	346,649	379,557
<i>Per Cent</i>								
Proportion of total turnover taxes to								
Total dominion internal revenue...	18.6	28.7	42.0	45.9	35.9	37.0	40.2	34.7
Total dominion tax revenue.....	10.3	19.2	27.2	29.6	22.7	22.6	23.7	19.0

¹ Accrued revenue.

² Cash receipts.

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them resold to retailers and consumers. Even here a check was imposed by the provision that the Minister of Finance might compel a manufacturer with an annual turnover under \$10,000 to take out a license if he used "a substantial portion of goods which are exempt from the tax in the manufacture of goods which are liable to the tax."

A special 6% import duty was laid on the importation of goods subject to the sales tax. This tax was refunded, however, when such goods were purchased by a licensed manufacturer or wholesaler who would have to pay a tax on their resale, but this refund was not allowed to unlicensed manufacturers who would not be taxed on the resale of such articles after further fabrication. The amount of sales tax paid on Canadian or imported articles was refunded when such articles were exported.

The series of exemptions under the 1921 and 1922 laws was maintained in the new law (with a few unimportant exceptions) and some additional articles were added to the list.

Amendments to the Manufacturers' Excise

In 1924 the rate of the Canadian production tax was changed from 6% to 5%. The limitation of licensing to manufacturers with an annual turnover in excess of \$10,000 was ended; all manufacturers now had to take out licenses, except such concerns manufacturing exclusively for local retail trade as might be specifically exempted by the Ministry of Finance. All wholesalers and jobbers were now permitted to take out licenses carrying exemption from the tax on goods purchased by them, but obligating them to pay the tax on sales made to other than licensed manufacturers or dealers.

The list of exempted articles was further widened in 1925, the most important additions being prepared cereal foods and a long list of industrial articles. In 1927 the rate of the tax was reduced from 5% to 4%. In the following year the rate was again reduced by another one per cent.

Yield of the Canadian Turnover Taxes

The Canadian turnover taxes have been a major element of the Dominion tax system since the date of their first levy. In the fiscal year ended March 31, 1921, the commodity transfer tax of 1920 produced \$38.1 millions, 18.6% of the dominion internal revenue and 10.3% of the dominion tax revenue, including customs receipts. As shown in Table 12, the rate increases of 1921 and 1922 and the change to a high-rate production tax in 1923 resulted in a rapid increase of revenue from the turnover tax. The maximum yield occurred in the fiscal year ended in 1924, when the tax produced \$101 millions, 45.9% of the dominion internal revenue. The reduction of the rate of the production tax from 6% to 5%, the increased scope of the exemptions from the tax, and a decrease in business turnover, combined to reduce the revenue from the tax by one-third in the following year. Between 1925 and 1927 there was a slight increase in the yield of the Canadian turnover tax. In the fiscal year ended March, 1928, the yield of the tax declined by about \$10 million to a total of \$72.1 millions. From one-fifth to one-third of the yield of the Canadian turnover taxes has been derived from the compensatory charges on imports.

APPENDIX II

TURNOVER TAXES IN THE UNITED STATES

The turnover tax is not entirely foreign to American fiscal history. A manufacturers' sales tax was levied by the Federal Government during the Civil War period. From 1918 to 1921, there were many proposals for federal turnover taxes as substitutes for the excess profits and corporation income taxes then in force, but, although several bills to this effect were introduced into Congress, none was enacted. Of the states, only West Virginia has enacted an all-inclusive turnover tax, but several others use partial general sales or turnover taxes as elements in their systems of business taxation.

THE FEDERAL CIVIL WAR TURNOVER TAXES

Among the proposals for additional federal internal revenue submitted to Congress in 1862 were several for general turnover taxes. These proposals had the support of the trade and commercial organizations of the country, particularly of those in the East. The Ways and Means Committee was opposed to the principle, however, and amendments to the revenue bill which would have provided for turnover taxation were voted down in both houses.

The Manufacturers' Sales Tax of 1862

In place of a general turnover tax, the revenue law of 1862 provided for a manufacturers' sales tax covering all manufactured articles and leaf tobacco, coal and raw cotton.¹ Where the quality of the taxed commodity was standardized or capable of classification, the tax was specific. Otherwise, ad valorem duties at rates between 3% and 5% were levied. An exemption up to \$600 was allowed for products consumed by their own producers. Since all manufacturing processes came under the tax and no rebates or drawbacks were allowed, cumulative taxation of constituent parts and of the finished article frequently occurred.

In subsequent years the rates of both the specific and ad valorem duties were increased, and by 1865 the general level of the tax, on an ad valorem basis, was 6%. In 1864, moreover, a 3% tax was levied on repairs that increased the value of the article by more than 10%, and a 5% tax was levied on the value added by subsidiary processes such as polishing, painting, ornamenting and so forth.

¹ Frederic C. Howe, "Taxation and Taxes in the United States under the Internal Revenue System, 1791-1895," New York, 1896, pp. 126-135; Harry Edwin Smith, "The United States Federal Internal Tax History from 1861 to 1871," Boston, 1914, pp. 225-252, 257-263.

TABLE 13: RECEIPTS FROM THE AMERICAN CIVIL WAR TURNOVER TAXES, FISCAL YEARS 1863 TO 1871
 (Source: Harry E. Smith, "The United States Internal Tax History from 1861 to 1871," Appendix. Computed by the National Industrial Conference Board)

Tax	July, 1862 to June, 1863	July, 1863 to June, 1864	July, 1864 to June, 1865	July, 1865 to June, 1866	July, 1866 to June, 1867	July, 1867 to June, 1868	July, 1868 to June, 1869	July, 1869 to June, 1870	July, 1870 to June, 1871	July, 1862 to June, 1871
<i>Amount (in thousands)</i>										
Manufacturers' sales tax.....	\$17,236	\$36,921	\$74,580	\$128,522	\$91,794	\$61,656	\$3,345	\$3,017	\$3,632	\$420,702
Other sales taxes.....	64	141	4,062	4,002	3,999	4,596	8,207	8,837	3,650	37,559
Combined sales taxes ¹	\$17,300	\$37,062	\$78,642	\$132,524	\$95,793	\$66,252	\$11,552	\$11,854	\$7,282	\$458,261
Total federal internal revenue.....	42,488	117,621	214,304	310,972	270,056	192,969	160,805	185,465	144,592	1,639,272
Total federal tax revenue ² ..	111,548	219,937	299,232	490,019	446,474	357,434	340,853	380,003	350,862	2,996,362
<i>Per Cent</i>										
Proportion of combined sales taxes to:										
Total federal internal revenue	40.7	31.5	36.7	42.6	35.5	34.3	7.2	6.4	5.0	28.0
Total federal tax revenue....	15.5	16.9	26.3	27.0	21.5	18.5	3.4	3.1	2.1	15.3

¹ Exclusive of the excises on tobacco and liquors.

² Including customs receipts on warrant basis.

In 1866, a special revenue commission proposed the abolition of the taxes on repairs, on clothes, on raw materials such as pig iron, coal and petroleum, and on books and printed matter. These recommendations were not followed exactly, but many of these taxes were abolished and others reduced by Congress in 1866 and subsequent years.

The Civil War Dealers' Sales Taxes

The revenue law of 1862, which imposed the manufacturers' sales tax, also levied a tax of 0.1% on sales at auctions. In 1864 the rate of this tax was increased to 0.25% and, by a related law, brokers and bankers were taxed 0.125% on sales of commodities and 0.05% on sales of instruments. The rates of both the auction sales tax and the bankers' and brokers' tax were reduced in 1866.

In 1867, the scope of the system of federal turnover taxes was broadened slightly by subjecting the sales of apothecaries, butchers, confectioners, plumbers and gasfitters to a tax of 0.1% on the annual excess of their turnover above \$25,000. Finally, in 1868, the sales by manufacturers of all articles not taxed under the remaining fragments of the manufacturers' sales tax were subjected to a tax of 0.2%. In 1870 all the federal sales taxes except those on tobacco and liquor were abolished.

Yield of the Civil War Turnover Taxes

During the nine years during which they were collected, the federal turnover taxes yielded 28% of the total of the Federal Government's internal revenue. As shown in Table 13, the manufacturers' sales tax in the year of its greatest productivity, 1866, yielded \$128.5 millions, 41.3% of the total federal internal revenue for the year. The other sales taxes never yielded such a high total. In 1869 they produced \$8.2 millions and in 1870, \$8.8 millions, on 5.1% of the total federal internal revenue for the former year and 4.8% for the latter.

THE PROPOSED FEDERAL TURNOVER TAX OF 1921

The general sales or turnover tax remained a dead issue in American federal politics until 1918. From 1918 on, the bitter opposition to the federal excess profits tax and to the high rates of the surtax on individual incomes provoked a search for possible substitutes. Among others, the project of a general sales tax was given consideration. At first, the proposal was approached gingerly, but as sentiment for a federal turnover tax augmented, the issue was debated openly and heatedly, and quite a voluminous literature on the subject appeared.¹ The acme of the controversy

¹ Morris R. Frey, "Needed Reform in the Present Federal Tax Laws," *Trust Companies Magazine*, November, 1919; Harris Winthrop & Co., "A Cross Section of Facts and Feelings in Business America," New York, 1919; Thomas S. Adama, "Needed Tax Reform in the United States," New York, 1920; Jules S. Bache, "Release Business from the Slavery of Taxation," New York, 1920; Hazen James Burton, "The Sales Tax," Minneapolis, 1920; Business Men's National Committee, "Primer Gross Sales or Turnover Tax," New York, 1920; Harris Winthrop & Co., "A Composite Picture of Business America," New York; Otto Kahn, "Some

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came in 1921 when the Senate Finance Committee opened its hearings to the proponents and opponents of the tax,¹ and Senator Smoot introduced alternative amendments to the House Revenue Bill providing for a commodity transfer tax and for a production tax.

The Smoot Amendments

A House bill for a "general sales tax" as a substitute for the excess profits tax and to provide revenue for a soldiers' bonus (H.R. 14956) was presented in the final session of the Sixty-sixth Congress. It received unfavorable notice on the floor of the House² and died in the Ways and Means Committee.

The first serious proposal for a federal turnover tax was made by Senator Smoot. It was introduced in 1921 as an amendment (S.B. 202) to the House Revenue Bill and provided for a 1% commodity transfer tax on all sales or leases of "goods, wares and merchandize" over an annual turnover of \$6,000. It had originally been intended to exempt sales of farm produce, but upon representation that most farm sales would come under the \$6,000 exemption, this provision was dropped. The bill as presented to the Senate exempted sales by the Federal Government, by foreign governments and by the states and their subdivisions, as well as sales by hospitals, by religious, charitable and educational institutions, and export sales. Estimates on the annual yield of this proposed tax varied widely; that of Mr. Joseph S. McCoy, the government actuary, was \$1,100 millions.

Sentiment against the bill was evident in the Senate discussions,³ and later in the session Senator Smoot offered an amendment to his earlier bill, changing its character to that of a modified production tax. This amendment provided a 3% tax on consumption sales by manufacturers and producers, accompanied by a counterbalancing 3% import duty on consumption goods. The bill itself did not cover goods sold by a manufacturer to another manufacturer for further working, but it was anticipated that the Treasury regulations would provide for exemption of sales when the purchaser gave assurance of further productive activity upon the purchased goods, making the purchasing manufacturer liable for the tax on

Suggestions on Tax Revision," "Addendum to Some Suggestions on Tax Revision and the Sales Tax," and "Two Years of Faulty Taxation and the Sales Tax," 1920; Charles E. Lord, "The Farmer and the Sales Tax," *Forum*, 1920, pp. 699-708; National Industrial Conference Board, "National Industrial Tax Conference," and "Second National Industrial Tax Conference," 1920; National Tax Association, "Proceedings of Thirteenth National Conference," 1920, pp. 169-219; Meyer D. Rothschild, "Gross Sales or Turnover Tax," New York, 1920; Robert R. Reece, "A Review and Discussion of the Opposition to a Commodity Sales Tax," New York, 1921; Hugh Satterlee, "Sales Taxes," New York, 1921; Otto Kahn, "A Plea for Prosperity," New York, 1922; Edwin R. A. Seligman, "The Sales Tax," in "Studies in Public Finance," New York, 1925.

¹ 67th Congress, 1st Session, Senate Finance Committee, "Hearings on the Revenue Act of 1921," pp. 21-496.

² Congressional Record, 66th Congress, 3rd Session, pp. 2328-2340.

³ *Ibid.*, 67th Congress, 1st Session, pp. 692, 5890, 6211, 7232, 7250, 7294, 7504.

the finished product. The same exemptions were allowed as in the earlier bill. The estimated yield of this tax was \$759 millions.

Still later in the session, the second Smoot amendment was reintroduced in a modified form, providing for a 1% tax on consumption sales by manufacturers and producers, with a 1% compensating import duty. The estimated annual yield of this tax was \$253 millions. In the debate on this last amendment, an interesting reversal of theory occurred. The two earlier turnover taxes had been proposed as consumption taxes; it had been argued that they could not become a burden on industry since they would invariably be shifted. The opposition seized upon this feature of the proposals and emphasized the characteristic of such consumption taxes of burdening the poor more heavily than the rich. In defending his third proposal, Senator Smoot argued that it was intended to be a tax on industry and not on the consumer, and that because of its low rate it would not be shifted.¹

The vote on the Smoot proposal for a production tax was taken on November 3, 1921. The proposal was defeated, 43 to 25, by a combination of agrarian Republicans such as LaFollette, Lenroot, Borah and Capper, and a few administration Republicans such as Penrose and McCormick, with the solid Democratic vote.² The following day the Smoot proposal for a 0.5% commodity transfer tax, with a hastily added amendment allowing credits to merchants and manufacturers for the amount of sales tax included in the prices of commodities purchased by them (which would have completely revolutionized the character of the tax, making it a net value transfer tax, and would have cut its revenue production to less than one-third of the original proposal, although neither the sponsor of the amendment nor the senators voting on it seemed to realize this), was voted down, 46 to 25.³ A third and final proposal for a 3% production tax failed on a *vide voce* vote three days later.⁴

Controversy over Proposed Federal Turnover Taxes

The motivation for the federal turnover tax proposals that originated from 1918 through 1921 was the desire in many quarters to abolish the excess profits tax and to abolish or at least to modify the surtax on individual incomes; it was also felt that a federal turnover tax would give an opportunity for eliminating the federal system of special wartime excises and sales taxes on luxuries and semi-luxuries. The proposed turnover taxes were viewed not as an addition to the existing federal internal revenue system but as a substitute for parts of it. Under the circumstances, it was natural that the proposals for federal sales and turnover taxes were not considered and discussed solely on their own merits; the opinions which individuals and groups in the country held on the subject were colored by their attitude toward the taxes for which it was proposed to substitute these general sales or turnover taxes.

In a broad way, it may be said that the business elements of the country favored the substitution of a turnover tax for the excess profits and other

← ¹ *Ibid.*, p. 7244. ² *Ibid.*, pp. 7254-7255. ³ *Ibid.*, p. 7298. ⁴ *Ibid.*, p. 7506.

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taxes from 1918 through 1921. In the fall of 1919, Harris Winthrop & Company, a banking firm, distributed a questionnaire among their clients, inviting opinions on the issue. Of 1,979 replies, 1,173 favored a federal turnover tax and 806 were opposed.¹ The strongest approval of the tax came from New England, and the opposition to the proposal was greatest in the southern and southwestern states. A second referendum on the question of a federal turnover tax, taken a year later by the same firm, showed 2,621 replies out of 3,573 favorable to the proposal.² A referendum (No. 34) held by the Chamber of Commerce of the United States in the winter of 1920 showed from 70% to 84%³ of its membership in favor of a turnover tax. The proponents of a federal turnover tax who testified at the hearings of the Senate Turnover Committee constituted a representative cross-section of opinion favorable to the tax. Among these were a prominent dry goods merchant, a representative of the Philadelphia Manufacturers' Club, a representative of the National Association of Real Estate Boards, a representative of the National Association of Manufacturers, a representative of the Boston Chamber of Commerce, a representative of the National Retail Dry Goods Association, and several representatives of the jewelers of the country.

The agricultural and labor elements of the country, the public utility interests and several prominent economists opposed the proposal of a federal turnover tax. These groups were not as active as the proponents of the tax in publishing their opinions in articles or pamphlets, but they presented their case at length before the Senate Finance Committee in 1921. They placed emphasis on the heavy tax burden that would be placed upon the poorer elements of the country by substituting a turnover tax for the excess profits or the luxury and semi-luxury taxes. They made much of the point that the tax would discriminate against special or single-process enterprises competing with multiple-process concerns, and they laid emphasis on the administrative difficulties of the tax.

The failure of the Smoot amendments to obtain congressional support was generally accepted by both proponents and opponents of the measure as closing the issue, and the controversy quickly subsided.

THE WEST VIRGINIA TURNOVER TAX

The state government of West Virginia in 1921 found itself faced by rapidly increasing expenditures and an insufficiency of revenue from existing sources. Opinion was fairly unanimous that the extractive industries of the state—coal mining and natural gas and oil production—should contribute more to the support of the state government than in the past, but apart from this, there was little agreement as to where further additional revenue should come from. During the closing days of the 1921 session of

¹ Harris Winthrop & Company, "Cross Section."

² *Ibid.*, "Composite Picture."

³ The form of the questions did not permit an exact ascertainment of the opinions concerned in the replies.

the legislature, a bill providing for a gross sales tax on all sales—industrial, commercial and casual—as well as on extractive production, was pressed through the legislature with little consideration, and enacted into law;¹ this turnover tax replaced an existing 0.75% corporation net income tax, which in 1920-1921, the last year of its operation, had produced \$1,332,000.

The Gross Sales Tax Law of 1921

The 1921 West Virginia tax applied to the total of business transactions of corporations and private business concerns and also to incidental transactions by individuals (although the latter application was largely inoperative in view of the large minimum exemption). The basis of the tax was "gross receipts," which included, in addition to income from sales, the income from services, discounts, interest, rentals, dividends and all other receipts, without allowance of deductions for losses or any expenses. An annual minimum exemption of \$10,000 was allowed, and national banks, insurance companies (separately taxed), mutual savings banks and non-profit educational, religious and charitable organizations were exempted on their sales or services. For constitutional reasons the law also exempted sales of articles for continuous transportation and delivery outside of West Virginia and the sales of imported articles sold in their original unbroken packages.

The rates of the 1921 law were: 0.4% of the gross sales value of extracted products—coal, oil, natural gas, limestone, sand or other mineral products; 0.2% of the gross proceeds of sales of tangible property except wholesale sales by jobbers or producers, and of the gross income of banks, railroads public utilities and other businesses and professions; 0.333% of the excess of the gross proceeds of sales by wholesalers and jobbers over and above the purchase price of the goods so sold. This discrimination between the rates applied to the various lines of productive and mercantile activity was intended to offset the differing ratios of net profits to turnover of the various types of concerns and so approximate the burden of the gross sales tax to that of a net profits tax.

In the case of concerns with a gross annual turnover in excess of \$60,000, returns had to be made, and the tax paid, quarterly; when the turnover was less than \$60,000, annual returns and tax payments were permitted.

The Business Occupation Tax Law of 1925

Several measures were introduced into the 1923 legislature to amend the Gross Sales Tax law of 1921. The tenor of these bills indicated a desire for heavier rates on the extractive industries and hostility to the principle of the turnover tax as applied to other industries and activities. One bill (H.B. 149), increasing the rates on the extractive industries and substituting a net profits tax on other business enterprises, was passed by the House of Delegates but failed in the Senate.²

¹ National Industrial Conference Board, "The Tax Problem in West Virginia," New York, 1925, pp. 152-159.

² *Ibid.*, p. 160.

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Bills of a similar character (S.B. 155, H.B. 198, H.B. 417) were introduced during the regular 1925 session of the legislature, but though one (H.B. 417) received favorable consideration by the House Committee on Finance, enactment into law did not follow. Amendment of the Gross Sales Tax law was postponed until the 1925 special session of the legislature.

Chapter I of the Special Session Statutes of 1925 created a "Business Occupation Tax" which was, in effect, a modification of the earlier Gross Sales Tax. This law gave a new definition of "gross income" and provided a new, higher and more complicated schedule of rates, but otherwise maintained the principle of the Gross Sales Tax law of 1921. The definition of "gross income" given by the 1925 statute is significant—"the value proceeding or accruing from the sale of tangible property (real or personal) or service, or both, and all receipts, actual or accrued, by reason of the investment of the capital of the business engaged in, including interest, discount, rentals, royalties, fees, or other emoluments however designated and without any deduction on account of the costs, interest or discount paid, or any other expense whatsoever; and without any deduction on account of losses." The tax accrues as of the date of closing the contract of sale, irrespective of the time of delivery or the time of payment. The West Virginia tax is thus a turnover tax of the broadest form possible, covering sales of land by realty firms and certain types of services, as well as the sales of commodities, and even including items of dividends and interest received, which are not within the scope of a general turnover or gross sales tax. A very significant item is the provision vesting authority in the Tax Commissioner "to make equitable and uniform rates for ascertaining in the case of production without sale, and in the case of sales to affiliated companies or persons where the receipts are not indicative of the true value of the subject of sales."

An examination by the Tax Commissioner of the comparative burden of the old corporation income tax as levied in 1919 and 1920 and of the Gross Sales Tax as levied in 1922 indicated that the rate schedule of the latter

TABLE 14: RELATIVE INCREASES OF TAX BURDENS ON TYPES OF BUSINESS ENTERPRISE IMPOSED BY THE WEST VIRGINIA 1921 GROSS SALES TAX

(Source: Supplementary Report of the State Tax Commissioner, 1923, p. 10)

Business of Reporting Concerns	Number of Companies Reporting	Gross Sales Tax on Companies Reporting, 1922	Net Income Excise on Companies Reporting, 1919 and 1920	Per Cent Increase of Tax Burdens
Production (extraction).....	311	\$1,461,506	\$661,720	121
Manufacturing.....	309	620,320	263,896	135
Sales, except wholesale.....	309	164,932	40,243	260
Wholesale sales.....	132	55,070	31,065	77
Banks and public utilities.....	117	141,604	92,927	52
Other businesses and professions.....	235	52,722	36,285	45

did not maintain the equilibrium of tax burden between the various lines of productive and economic activity which had been imposed by the earlier net income tax. As shown in Table 14, the burden of the Gross Sales Tax on concerns selling at retail was 260% greater than the burden of the former excise on net incomes. In the case of manufacturing concerns the increase was 135%. The increase for miscellaneous business and professions was only 45%. The Gross Sales Tax imposed only an additional 52% tax burden on banks and public utilities.

With a view to remedying these discriminations of the Gross Sales Tax, the schedule of rates was revised. An additional yield, \$4.3 millions as against the \$2.5 millions to \$3 millions of the Gross Sales Tax, was required from the new Business Occupation Tax. Consequently, the revision of the rate schedule took the form of marked increases of the rates on those lines that had had their tax burdens increased least by the 1921 Gross Sales Tax; the rates on those types of concerns that had been subjected to the heaviest increases under the 1921 tax were increased either slightly or not at all. Amusement places were taxed 1% on their gross incomes as a concession to the feeling that their incomes represented a luxury, or at least a sumptuary expenditure, on the part of their patrons. The schedule of rates is presented in Table 15.

**TABLE 15: RATE SCHEDULE OF THE WEST VIRGINIA
BUSINESS OCCUPATION TAX OF 1925**

General Class of Taxed Concerns	Specific Business Activity of Taxed Concerns	Rate of Tax
Extractive industries	Coal mining.....	0.42%
	Oil production.....	1.00
	Natural gas production.....	1.85
	Extraction of limestone, sand or other mineral products.....	0.45
	Lumbering.....	0.45
	Manufacturers' sales.....	0.21
Manufacturing	Manufacturers' sales.....	0.21
	Sales of tangible property other than by wholesalers or jobbers.....	0.20
Merchandizing	Wholesalers' and jobbers' sales.....	0.05
	Wholesalers' and jobbers' sales.....	0.05
Banks and public service enterprises	Banks.....	0.3
	Steam railroads.....	1.0
	Street railways.....	0.4
	Pipe line companies.....	1.0
	Telephone and telegraph, express, light and power companies.....	0.6
	Other public service companies.....	0.4
Contractors	Gross income of contractors.....	0.3
Amusements	Gross income from places of amusement.....	1.0
Residuary	All other business activities.....	0.3

TABLE 16: RECEIPTS FROM THE WEST VIRGINIA TURNOVER TAXES, BY INDUSTRIES, FISCAL YEARS 1922 TO 1928

(Source: Biennial Reports, State Tax Commission)

Business Classification	October, 1921 to June, 1922	July, 1922 to June, 1923	July, 1923 to June, 1924	July, 1924 to June, 1925	July, 1925 to June, 1926	July, 1926 to June, 1927	July, 1927 to June, 1928
<i>Amount (in thousands)</i>							
Coal production.....	\$516.8	\$1,084.5	\$1,093.8	\$731.8	\$969.7	\$1,182.7	\$1,022.0
Oil and gas production.....	150.6	231.7	221.6	199.8	152.3	705.5	615.5
Clay, sand, etc., production.....	13.1	18.0	24.2	25.0	29.3	31.9	30.2
Timber production.....	..	..	..	..	5.4	25.3	30.2
Total production.....	\$680.5	\$1,334.2	\$1,339.6	\$956.6	\$1,156.7	\$1,945.4	\$1,697.9
Manufacturing.....	339.4	656.9	780.0	725.9	842.1	791.2	788.3
Sales, exclusive of wholesale ¹	269.6	442.2	586.8	539.3	555.4	580.1	562.2
Sales, wholesale.....	31.4	52.4	61.9	56.3	71.7	88.9	85.9
Banks and public utilities.....	68.3	101.9	115.3	105.1	298.0	402.5	399.3
Other businesses and professions ²	73.2	120.8	172.4	167.9	235.3	268.0	272.4
Total.....	\$1,462.4	\$2,708.4	\$3,056.0	\$2,551.1	\$3,159.2	\$4,076.1	\$3,806.0
Total state tax revenue³.....	\$7,200.0	\$11,493.0	\$13,030.0	\$13,899.0	\$15,532.0	\$17,135.0	\$18,619.5
Combined state and local tax revenue⁴.....	\$31,721.0	\$49,927.0	\$56,305.0	\$58,380.0	\$62,309.0	\$64,913.0	..

Percentage Distribution

Coal production.....	35.3	40.0	35.8	28.7	30.7	29.0	26.8
Oil and gas production.....	10.3	8.6	7.2	7.8	4.8	17.3	16.2
Clay, sand, etc., production.....	0.9	0.7	0.8	1.0	1.0	0.8	0.8
Timber production.....	..	..	..	..	0.2	0.6	0.8
Total production.....	46.5	49.3	43.8	37.5	36.7	47.7	44.6
Manufacturing.....	23.2	24.2	25.6	28.5	26.7	19.4	20.7
Sales, exclusive of wholesale ¹	18.4	16.3	19.2	21.1	17.6	14.2	14.8
Sales, wholesale.....	2.2	1.9	2.0	2.2	2.2	2.2	2.2
Banks and other public utilities.....	4.7	3.8	3.8	4.1	9.4	9.9	10.5
Other businesses and professions ²	5.0	4.5	5.6	6.6	7.4	6.6	7.2
Total.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Ratio of gross sales tax receipts to total state tax revenue.....	20.3	23.6	23.5	18.4	20.3	23.8	20.4
Ratio of gross sales tax receipts to combined state and local tax revenue.....	4.6	5.4	5.4	4.4	5.1	6.3	..

¹ Casual sales not taxed after 1924-1925.

² Professions not taxed after 1924-1925.

³ U. S. Bureau of the Census, "Financial Statistics of States" series.

⁴ National Industrial Conference Board, "Cost of Government in the United States" series.

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The list of exemptions remained unchanged, but the scope of the tax was narrowed so as no longer to include professional services. Sales of real or personal property, not carried on as a business, were also excluded from the Business Occupation Tax. A number of administrative changes were made. Among these were the provision for annual instead of quarterly payments when the tax on a concern is less than \$100, and the reduction of the fine for fraud or evasion from \$5,000 to \$1,000.

The business interests of West Virginia are far from satisfied with the Business Corporation Tax in its present form,¹ but no changes have been made in the 1925 law.

Yield of the West Virginia Turnover Taxes

From its earliest application, the West Virginia turnover tax proved a better revenue producer than its predecessor, the corporation net income excise. As shown in Table 16, from 1921-1922 to 1923-1924 over one-third of this revenue was paid by the coal companies of the state. Manufacturing companies paid nearly a fourth of the total.

The most noticeable changes in the distribution of revenue receipts resulting from the substitution of the Business Occupation Tax for the Gross Sales Tax were sharp increases in the revenue from banking and public utility corporations, from unclassified business concerns, and from extractive production. The tax burdens on manufacturers, wholesalers and retailers remained practically unchanged.

The annual revenue of the Gross Sales Tax, under the rates of the 1921 law, varied between \$2.5 millions and \$3 millions. This represented over one-fifth of the state government's revenue, and from 4.5% to 5.5% of the combined state and local tax revenue of West Virginia.

Far from producing an additional one to one-and-a-half millions of tax revenue, as had been anticipated, the Business Occupation Tax of 1925 resulted in a bare \$600,000 increase during the first year of operation. In fact, the revenue from this tax during the fiscal year 1925-1926 was only \$100,000 in excess of the yield of the Gross Sales Tax in 1923-1924, the latter's best year. During the fiscal year 1926-1927, however, the Business Occupation Tax measured up to its revenue expectations, and produced \$4,076.1 millions of revenue, which represented 23.8% of West Virginia's state tax revenue for the year and 6.3% of the combined state and local tax revenue. The yield of the Business Occupation Tax in the fiscal year 1927-1928 fell off considerably from the high figure of the preceding year.

OTHER STATE TURNOVER TAXES

Of the American states, only West Virginia levies a general sales or turnover tax applying to all transactions or all business done within the state. Four other states, Pennsylvania, Connecticut, Delaware and Missouri, provide for the taxation of certain classes or groups of manufacturing

¹ J. E. Brunson, "Operation of Sales Tax in West Virginia," Greenville, S. C., 1928.

or mercantile enterprise on a gross income basis, either by the state itself or by local governments; these state gross income taxes are allied to turnover taxation and deserve consideration as aspects of turnover taxation.

Of the dependencies of the United States, the Philippine Islands and Porto Rico levy turnover taxes of the commodity transfer type.

The Pennsylvania Mercantile License Tax

The Pennsylvania Mercantile License Tax, although levied as a license tax on wholesale and retail merchants only, and excluding sales by manufacturers and agriculturalists of their own products, has some of the characteristics of a general sales or turnover tax.¹ It was first levied in 1821 (P.L. 244) to apply only to dealers in foreign wares. In 1841 (P.L. 307) it was extended to all dealers. Its re-enactment and codification in 1899 (P.L. 184) is the basis of the present tax.

The Mercantile License Tax is imposed on individuals, firms, corporations and all other vendors of goods, wares and merchandise. The law provides three rates: a \$2.00 annual license charge plus a 0.1% tax on "the whole volume, gross, of business transacted annually" of retailers; a \$5.00 annual license charge plus a 0.05% tax on the turnover of wholesalers; and a 0.025% tax on exchange sales. The tax is collected on the basis of self-assessments checked by a corps of local "mercantile appraisers."

The tax has been a fruitful source of revenue to the state government, as is shown in Table 17. Its yield increased from \$1.2 millions in 1915 to \$3.8 millions in 1926-1927. In the latter year it represented 3.6% of the state government's tax revenue, and 0.9% of Pennsylvania's combined state and local tax revenue. Its cost of administration is excessively high, though of recent years it has shown a tendency to decrease. It was 11.3% in 1915, 9.7% in 1919, 8% in 1923, and has averaged 7.8% in recent years.² The determination of liability to the tax in borderline cases has resulted in much judicial controversy. For at least two decades there has been a strong, though probably not a majority, current of disapproval of the mercantile license tax.³

The Connecticut Merchants' and Manufacturers' Tax

In 1921 (ch. 393), Connecticut levied a privilege tax on unincorporated manufacturing and mercantile concerns. The measure of the tax was the gross income or turnover of the taxed concerns attributable to Connecticut business (determined by the proportion of each taxed firm's real and tangible personal property located within the state). The rates were 0.1% on the

¹ Fox, "Taxation for State Purposes in Pennsylvania," pp. 103-110.

² *Ibid.*, p. 109, and letter from Pennsylvania Auditor General dated April 16, 1929.

³ Report of the Pennsylvania Joint Committee upon Revision of the Corporation and Revenue Laws, 1909-1911, pp. 167-168; Report of the Committee on Taxation Study to the Council of the City of Pittsburgh, 1916, pp. 81-82; Brief of Allied Business Men's League of Pennsylvania to Governor Sproul, *Philadelphia Public Ledger*, April 20, 1921.

TABLE 17: RECEIPTS FROM THE PENNSYLVANIA MERCANTILE LICENSE TAX, FISCAL YEARS 1915 TO 1928
(Source: Reports of the State Auditor General)

Tax	December, 1914 to November, 1915	December, 1915 to November, 1916	December, 1916 to November, 1917	December, 1917 to November, 1918	December, 1918 to November, 1919	December, 1919 to November, 1920	June, 1921 to May, 1922	June, 1922 to May, 1923	June, 1923 to May, 1924	June, 1924 to May, 1925	June, 1925 to May, 1926	June, 1926 to May, 1927	June, 1927 to May, 1928
<i>Amount (in thousands)</i>													
Tax on retail sales	\$909	\$951	\$1,054	\$1,258	\$1,548	\$1,198	\$2,323	\$2,600	\$2,212	\$2,743	\$2,730	\$2,924	\$3,280
Tax on wholesale sales	340	349	427	557	651	817	779	825	730	839	814	850	989
Total mercantile license tax	\$1,249	\$1,300	\$1,481	\$1,815	\$2,199	\$2,015	\$3,102	\$3,425	\$2,942	\$3,582	\$3,544	\$3,774	\$4,269
Total state tax revenue¹	30,438	35,039	29,911	41,858	..	..	67,189	76,580	87,530	91,336	99,823	105,678	120,850
Total state and local tax revenue² . . . . .	..	..	..	..	..	..	300,082	324,816	352,359	378,501	410,711	439,046	..
<i>Per Cent</i>													
Proportion of mercantile license tax to:													
Total state tax revenue	4.1	3.7	5.0	4.3	..	..	4.6	4.5	3.4	3.9	3.6	3.6	3.5
Total state and local tax revenue . . . . .	..	..	..	..	..	..	1.0	1.1	0.8	0.9	0.9	0.9	..

¹ U. S. Bureau of the Census, "Financial Statistics of States" series.

² National Industrial Conference Board, "Cost of Government in the United States" series.

gross income from manufacturing and retail merchandizing and 0.025% on the gross income from wholesale merchandizing, with a \$5 minimum tax. In case a firm suffered a net loss for the year, it paid only the minimum tax.

The Connecticut merchants' and manufacturers' tax is often referred to as a general sales or turnover tax. Its limited scope and the provision for payment of a minimum tax in cases of net loss might properly exclude it from this category of taxes. These provisions, however, deserve consideration as a modification or variation of the general principle of turnover taxation. The annual yield of the tax is between \$500,000 and \$600,000.

The Delaware Merchants' and Manufacturers' License Taxes

Non-incorporated merchants and manufacturers in Delaware, other than wholesale merchants, pay 0.1% on their gross income. Wholesale merchants pay 0.025% on their gross income.

The administration of the tax is lax. The taxpayers merely report to the county clerk of the peace that their gross income does not exceed a certain figure, and pay a tax on that figure. Probably only the lightness of the rates has preserved the tax. The tax collected from wholesale and retail merchants amounts to about \$85,000 annually and that from manufacturers to about \$25,000 annually.

The Missouri Local Turnover Taxes

As permitted by state law (Mo. Rev. Stat., 1909, No. 9857), the city of St. Louis levies a 0.1% tax on the turnover of manufacturers and merchants. The tax on manufacturers is measured by their total output, irrespective of its destination; that on merchants is measured by their domestic sales. A similar local turnover tax is levied in Kansas City.

The Philippine Islands Commodity Transfer Tax

The Philippine Revenue Law of 1904 (Act 1189, Art. XVI) imposed a 0.333% tax on "the gross value of all goods, wares and merchandize sold, bartered or exchanged for domestic consumption." The act specifically included the services of telephone and telegraph companies, light, heat and power plants, and boat construction and dockyard companies; common carriers were subjected to a 1% rate. Sales of commodities taxed under the liquor, tobacco and other special excises were exempted from the commodity transfer tax. So, also, were sales by agriculturalists of their own produce, sales by butchers, bakers and merchants in the retail markets, export sales, and sales of animals under 500 pesos.

In 1915 (Act 2432), the rate of the tax was raised to 1%, but no change was made in its structure. In 1923 (Act 3065), an additional 0.5% was temporarily added to the existing 1% rate. This temporary increase was continued in 1924 (Act 3183) and made permanent in 1925 (Act 3243).

The administration of the Philippine tax is an interesting example of simplicity and effectiveness adapted to the circumstances. Each taxpayer is provided with an annual license form with four coupons attached. At

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the end of each quarter, the total of sales and the amount of tax due is noted on the appropriate coupon, which is sent with the remittance of the tax to the tax collector. Serially numbered stamps covering the amount of the tax paid are then sent to the taxpayer. These are attached to the license form, which must be kept on display.

The Porto Rican Turnover Taxes

In 1925 (No. 74, Title III), the Porto Rican Assembly enacted a 2% tax on the sales of all commodities not already taxed under the system of excises. The scope of this commodity transfer tax was limited, however, since many of the most important articles were covered by the excise system; in addition to alcoholic drinks and tobacco products, this group included sugar, musical instruments, motors and motor accessories, cameras and photographic accessories, typewriters, comptometers and cash registers, lighting apparatus, and other specific items. In addition, foodstuffs, gas, electricity, fuel, newspapers and books and (by error) jewels were exempt. A minimum turnover exemption of \$100 per month was allowed. The tax was paid by affixing stamps to the return forms.

In 1927 (No. 17), the exemption of jewelry was dropped and sales of real property, presumably non-taxable under the 1925 law, were specifically exempted. Moreover, it was provided that the taxation of the sale of any specific article exempted all future transfers of that article; this provision gave the tax the character of a production tax.